No. 03-1274

Supreme Court, U.S.
FILED
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In The Supreme Court of the United States

JUANITA SWEDENBURG, *et al.*,

Petitioners,

v.

EDWARD D. KELLY, *et al.*,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

JOINT APPENDIX

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Certiorari Granted: May 24, 2004

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Decision and Order of the United States District Court for the Southern District of New York, Filed November 12, 2002..... 34a

Judgment of the United States District Court for the Southern District of New York, Dated December 10, 2002..... 72a

RELEVANT DOCKET ENTRIES

U.S. District Court
Southern District of New York (Foley Square)
CIVIL DOCKET FOR CASE #: 1:00-cv-00778-RMB-HBP

Filing Date	#	Docket Text
02/03/2000	1	COMPLAINT filed; Summons issued and Notice pursuant to 28 U.S.C. 636(c); FILING FEE $150.00 RECEIPT #365606. (bm) (Entered: 02/07/2000)
		* * *
09/05/2000	26	Decision and ORDER; denying [15-1] motion to dismiss the complaint purs to FRCP 12(b)(6) for failure to state a claim; Counsel are directed forthwith to contact Court Deputy Christine Murray at (212) 805-6715 to arrange a scheduling conference with the Court; (signed by Judge Richard M. Berman); Copies mailed. (djc) (Entered: 09/06/2000)
09/06/2000	27	Transcript of record of proceedings before Judge Richard M. Berman for the date(s) of 7/21/00. (lam) (Entered: 09/06/2000)
		* * *
10/10/2000	34	AMENDED ANSWER to Complaint by Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello: amends [32-1] answer (cd) (Entered: 10/11/2000)
10/19/2000	36	ANSWER to Complaint by Intervenor-Defts (sac) (Entered: 10/24/2000)
		* * *

06/07/2001	58	NOTICE OF MOTION (FILED ON SERVICE DATE) by plaintiffs, for an order granting summary judgment. Return date 10/17/01. (kw) Modified on 06/12/2001 (Entered: 06/12/2001)
06/11/2001	59	MEMORANDUM OF LAW by plaintiffs in support of [58-1] motion for an order granting summary judgment. (kw) Modified on 06/12/2001 (Entered: 06/12/2001)
06/11/2001	60	RULE 56.1 STATEMENT filed by plaintiffs. (kw) (Entered: 06/12/2001)

* * *

08/17/2001	65	NOTICE OF CROSS MOTION (FILED ON SERVICE DATE) by Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello and Intervenor-defendants, for an order granting summary judgment. Affidavits of Cook, Hellerstein, Kitt, Wechsler, Butts III, McKeon, Cummings, McDevitt and Meresman are attached. Return date is 10/17/01. (Received in the night deposit box on 8/17/01). (kw) Modified on 08/22/2001 (Entered: 08/22/2001)
08/17/2001	66	DECLARATION of Frederick P. Schaffer by defendant in support of Re: [65-1] cross motion for an order granting summary judgment, and in opposition to [58-1] motion for order granting summary judgment. (Received in the night deposit box on 8/17/01). (kw) (entered: 08/22/2001)

08/17/2001	67	DECLARATION of Randy M. Mastro by defendants in support of Re: [65-1] cross motion for an order granting summary judgment, and in opposition to [58-1] motion for an order granting summary judgment. (Received in the night deposit box on 8/17/01). (kw) (entered: 08/22/2001)
08/17/2001	68	MEMORANDUM OF LAW by defendants in support of re: [65-1] cross motion for an order granting summary judgment, and in opposition to [57-1] motion for an Order pursuant to Rule 1.3(c) of the Local Rules of this Court admitting Marni Soupcoff to the bar of this Court pro hav [sic] vice on behalf of plaintiffs. (Received in the night deposit box on 8/17/01). (kw) (Entered 08/22/2001)
08/17/2001	69	RULE 56.1 STATEMENT and Counter-statement of Material facts pursuant to Rule 56.1(b) filed by defendants and intervenor-defendants. (Received in the night deposit box on 8/17/01). (kw) (Entered: 08/22/2001)

* * *

10/17/2001	73	REPLY MEMORANDUM by Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick Fitzgerald, Cortes DeRussy, Robin Brooks of [58-1] motion for an order granting summary judgment. (jco) (Entered: 10/19/2001)
10/17/2001	74	DECLARATION of Clint Bolick by Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick Fitzgerald, Cortes DeRussy, Robin Brooks

in support of [73-1] reply memorandum. (jco) (Entered: 10/19/2001)

10/17/2001 75 RULE 56.1 STATEMENT filed by Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick Fitzgerald, Cortes DeRussy, Robin Brooks. (jco) (Entered: 10/19/2001)

10/17/2001 76 DECLARATION of Clint Bolick by Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick Fitzgerald, Cortes DeRussy, Robin Brooks in support of [73-1] reply memorandum. (jco) (Entered: 10/19/2001)

* * *

11/13/2001 81 REPLY MEMORANDUM by Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello, and intervenor-defendants re: in support [65-1] cross motion for an order granting summary judgment, and in opposition to plaintiffs' motion for summary judgment, and reply memorandum of the State University of New York, The City University of New York, Fordham University, and St. Francis College as Amici Curiae in support of defendants and intervento [sic]-defendants' cross-motion for summary judgment. (bai) (Entered: 11/14/2001)

11/13/2001 82 REPLY DECLARATION of Randy M. Mastro by Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello Re: in support of defendants and intevenor-defendants' [65-1] cross motion for an order granting summary judgment, and in opposition to plaintiffs' motion for

summary judgment. exhibits attached. (bai) Modified on 11/14/2001 (Entered: 11/14/2001)

* * *

06/07/2002 84 Transcript of record of proceedings before Judge Richard M. Berman for the date(s) of 4/17/02 at 9:00 a.m. (ph) (Entered: 06/11/2002)

* * *

11/12/2001 86 DECISION AND ORDER; that for the reasons set forth in this Order, plaintiffs' [58-1] motion for summary judgment is granted and defendants' [65-1] motion for summary judgment is denied; the Court would like to have additional input from the parties before deciding the issue of remedy, and will hold a conference for this purpose on 12/5/02 at 11:00 a.m. in Courtroom 706 of the Thurgood Marshall Courthouse, 40 Centre Street; the parties are requested forthwith to "meet and confer" to determine whether consensus can be reached with respect to remedy; additional briefing, which may become useful, is not called for at this time. (signed by Judge Richard M. Berman); document forwarded to Judgment Clerk. (kkc) (Entered: 11/14/2002)

11/15/2002 87 JUDGMENT; that for the reasons stated in the Court's Decision and Order dated 11/12/02, plaintiffs' motion for summary judgment is granted, and defendant's motion for summary judgment is denied. (signed by J. Michael McMahon, Acting

Clerk of Court); Mailed copies and notice of right to appeal. Entered On Docket: 11/19/02. Judgment Vacated as per Chambers direction. Case is still pending (11/22/02). (pl) Modified on 11/22/2002 (Entered: 11/19/2002)

* * *

12/10/2002 93 Letter field by Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick Fitzgerald, Cortes DeRussy, Robin Brooks addressed to Judge Richard M. Berman from Clint Bolick, dated 12/2/02, re: Enclosed is Plaintiffs' proposed final judgment. (dle) Modified on 12/31/2002 (Entered: 12/16/2002)

12/10/2002 94 Letter filed addressed to Judge Richard M. Berman from Howard Graff, dated 12/3/02, re: Intervenor-Defendants submits this letter expresly [sic] preserving their objections to this Court's 11/12/02 Decision and Order, and w/out waiver of any of the grounds for appealing the Decision, submit herewith a proposed Final Judgment providing that, as a remedy for the discrimination perceived by this Court in the exemption of N.Y. farm wineries from the overall prohibition on direct shipments of alcoholic beverages to consummers [sic], the "farm winery exemption" contained in N.Y. Alco. Bev. Cont. Law shall be severed and invalidated; accompanied by Supplemental Affidavit of Howard P. Kitt, sworn to on 12/2/02. (dle) Modified on 01/06/2003 (Entered: 12/16/2002)

* * *

12/11/2002	91	JUDGMENT; that for the reasons stated in the Court's Decision and Order dated 11/12/02, plaintiffs' motion for summary judgment is granted, that defendants' motion for summary judgment is denied; defendants are enjoined from enforcing N.Y. Alco. and Bev. Cont. Law sections 102(1)(c) and (d) 102(a) in the manner that is set forth in this Judgment; enforcement of this judgment (and its injunctions are stayed pending any appeal to the U.S. Court of Appeals for the Second Circuit or, if no appeal is taken until expiration of the time for taking such appeal. (signed by Judge Richard M. Berman); Mailed copies and notice of right to appeal. Entered On Docket: 12/12/02. (pl) (Entered: 12/12/2002)

* * *

12/29/2002	100	NOTICE OF APPEAL by Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello from [91-1] judgment order. Copies of notice of appeal mailed to Attorney(s) of Record: Clint Bolick, Esq., Howard Graff, Esq., Steve Simpson, Esq., Robert M. Heller, Esq., Randy M. Mastro, Esq., Joseph Fleming, Esq., Michael Kalmus, Esq., John O'Mara, Esq. and Alan J. Gardner, Esq. $105.00 Appeal filing fee paid 12/29/02 on receipt # E 0460428. (dt) (Entered: 12/31/2002)
01/08/2003	101	NOTICE OF APPEAL by Charmer Industries, Inc., Peerless Importers Inc., Eber Brothers Wine & Liquor Corp., Premier Beverage Co., LLC.,

Metropolitan Package Store Association, Inc., and Local 2D of the Allied Food and Commercial Workers International Union, (Intervenors-Defendants.) from [45-1] motion for an order to compel the State defendants, Edward F. Kelly, Lawrence J. Gedda, and Joseph Zarriello, to respond to plaintiffs' Request for Admissions, [42-1] motion clarifying the matters at issue in this case. Copies of notice of appeal mailed to Attorney(s) of Record: August L. Fietkau, Clint Bolick, Stephen Simpson, Lance J. Gotko. $105.00 APPEAL FILING FEE PAID ON 1/10/03, ON RECEIPT # E 046132. (pr) (Entered: 01/13/2003)

* * *

United States Court of Appeals
for the Second Circuit

5/16/03 Intervenor-Appellants Charmer Industries, Peerless Importers, Local 2D, Metropolitan Package brief FILED with proof of service.

5/16/03 Appellant Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello, Eber Brothers Wine, Premier Beverage Co brief FILED with proof of service.

5/16/03 Appellants Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello, Charmer Industries, Peerless Importers, Local 2D of the Alli, Metropolitan Package, Eber Brothers Wine, Premier Beverage Co joint appendix filed w/pfs. Number of volumes: 6.

* * *

6/16/03 Appellees Juanita Swedenburg, Juanita Swedenburg, David Lucas, David Lucas, Patrick G. Fitzgerald, Cortes Derussy, Robin Brooks brief filed with proof of service.

* * *

6/30/03 Intervenor-appellants Charmer Industries, Peerless Importers, Local 2D of the Alli, Appellant Metropolitan Package in 02-9511 reply brief filed with proof of service.

* * *

7/2/03 Appellant Edward F. Kelly, Lawrence J. Gedda, Joseph Zarriello reply brief filed with proof of service.

* * *

9/3/03	Case heard before NEWMAN, SOTOMAYOR, WESLEY, C.JJ. (TAPE: CD Date: 9/3/03)
	* * *
2/12/04	Judgment of the district court is Affirmed in part, Reversed and Remanded in part by published signed opinion filed. (RCW) [02-1266]
2/12/04	Judgment filed.
	* * *

NEW YORK ALCOHOLIC BEVERAGE CONTROL LAW

§ 2. Policy of state and purpose of chapter

It is hereby declared as the policy of the state that it is necessary to regulate and control the manufacture, sale and distribution within the state of alcoholic beverages for the purpose of fostering and promoting temperance in their consumption and respect for and obedience to law. It is hereby declared that such policy will best be carried out by empowering the liquor authority of the state to determine whether public convenience and advantage will be promoted by the issuance of licenses to traffic in alcoholic beverages, the increase or decrease in the number thereof and the location of premises licensed thereby, subject only to the right of judicial review hereinafter provided for. It is the purpose of this chapter to carry out that policy in the public interest. The restrictions, regulations and provisions contained in this chapter are enacted by the legislature for the protection, health, welfare and safety of the people of the state.

§ 3. Definitions

Whenever used in this chapter, unless the context requires otherwise:

37. "Winery" means and includes any place or premises wherein wines are manufactured from any fruit or brandies distilled as the by-product of wine or other fruit or cordials compounded and also includes a winery for the manufacture of wine in any state other than New York state and which has and maintains a branch factory, office or storeroom within the state of New York and receives wine in this state consigned to a United States

government bonded winery, warehouse or storeroom located within the state.

§ 77. Sale of wine in bulk

1. A winery license shall authorize the holder thereof to operate a winery for the manufacture of wine at the premises specifically designated in the license and to receive and possess wine from other states consigned to a United States government bonded winery, warehouse or storeroom located within the state. Such a license shall also authorize the sale in bulk by such licensee from the licensed premises of the products manufactured under such license and wine received by such licensee from any other state to any winery licensee, any distiller licensee or to a permittee engaged in the manufacturer of products which are unfit for beverage use and to sell or deliver such wine to persons outside the state pursuant to the laws of the place of such sale or delivery. It shall also authorize the holders thereof to sell from the licensed premises to a licensed wholesaler or retailer, or to a corporation operating railroad cars or aircraft for consumption on such carriers, wine manufactured or received by the licensee as above set forth in the original sealed containers of not more than fifteen gallons each and to sell or deliver such wine to persons outside the state pursuant to the laws of the place of such sale or delivery. All wine sold by such licensee shall be securely sealed and have attached thereto a label setting forth such information as shall be required by this chapter.

2. Notwithstanding any provision of this chapter to the contrary, and upon payment to the liquor authority of an additional annual fee of one hundred twenty-five dollars,

the liquor authority may in its discretion and upon such terms and conditions as it may prescribe, issue to a licensed winery upon application therefor a certificate authorizing such winery to sell wine at retail in sealed containers to a regularly organized church, synagogue or religious organization for sacramental purposes, and to a householder for consumption in his home.

3. [Repealed]

4. (a) A licensed winery may manufacture, bottle and sell fruit juice, fruit jellies and fruit preserves, tonics and unpotable wine cooking sauces on and from licensed premises, provided that the winery license number does not appear on the labels of such products, and operate a restaurant on the premises.

(b) Such license shall authorize the holder thereof to store and sell gift items in a tax-paid room upon the licensed premises. These gift items shall be limited to the following categories:

(1) Wine supplies, which shall include any item utilized for the storage, serving or consumption of wine. These supplies may be sold as single items or may be combined into a package sold as a unit item or may be combined into a package containing wine or a wine product;

(2) Food items, which shall include any food or food product not specifically prepared for immediate consumption upon the premises. Such food items may be combined into a package containing wine or a wine product;

(3) Souvenirs, which shall include any item which can be construed to represent or serve as a memento of the licensed premises or of the state of New York.

(4) (Added, L 1993) New York state labelled wine produced or manufactured by any other New York state winery or farm winery licensee. Such wine may be purchased outright by the licensee from a New York winery or farm winery licensee or obtained on a consignment basis pursuant to a written agreement between the selling and purchasing licensee.

(c) Notwithstanding any provision of this chapter to the contrary, any winery licensee or farm winery licensee may charge:

(1) For tours of their premises; and

(2) For any wine tastings.

(d) Wine grape growers or wine producer organizations or associations, incorporated within the state for the purpose of wine or wine grape promotion may hold wine tastings for purposes of education in the production and proper use of wine products under the same rules applying to winery licensees.

(e) The authority is hereby authorized to promulgate rules and regulations to effectuate the purposes of this subdivision.

(f) A licensed winery may engage in any other business on the licensed premises subject to such rules and regulations as the liquor authority may prescribe. In prescribing such rules and regulations, the liquor authority shall promote the expansion and profitability of wine production and of tourism in New York, thereby promoting the conservation, production and enhancement of New York state agricultural lands. Further, such rules and regulations [fig 1] shall determine which businesses will be compatible with the policy and purposes of this chapter

and shall consider the effect of particular businesses on the community and area in the vicinity of the winery licensee.

5. A licensed winery shall be permitted to remain open for the purposes of selling its products, in accordance with the provisions of subdivisions two and three of this section, and/or of conducting public tours of its winery and/or to sell New York state labelled wine, by the bottle, at the state fair, at recognized county fairs and at farmers markets operated on a not-for-profit basis in accordance with the provisions of section seventy-six of this article on Sunday between the hours of ten o'clock in the morning and midnight.

The authority is hereby authorized to promulgate rules and regulations to effectuate the purposes of this subdivision.

§ 100. Alcoholic beverages generally

1. No person shall manufacture for sale or sell at wholesale or retail any alcoholic beverage within the state without obtaining the appropriate license therefor required by this chapter.

2. No manufacturer and no wholesaler shall sell, or agree to sell or deliver in this state any alcoholic beverage for the purposes of resale to any person who is not duly licensed pursuant to this chapter to sell such beverages, at wholesale or retail, as the case may be, at the time of such agreement and sale.

§ 161. Invalidity; effect of

If any part, provision or section of this chapter or the application thereof to any person or circumstances shall be held invalid by any court of competent jurisdiction, the remainder thereof or the application of such part, provision or section to any other person or circumstances shall not be affected thereby.

LAWS OF NEW YORK, 1934

CHAPTER 478

AN ACT relating to alcoholic beverages, constituting chapter three-b of the consolidated laws

Became a law May 10, 1934, with the approval of the Governor. Passed, on message of necessity, three-fifths being present

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

CHAPTER 3-B OF THE CONSOLIDATED LAWS

ALCOHOLIC BEVERAGE CONTROL LAW

Article 1. Short title; policy of state and purpose of chapter; definitions. (§§ 1-3.)
2. Liquor authority. (§§ 10-18.)
3. Local alcoholic beverage control boards. (§§ 30-43.)
4. Special provisions relating to beer. (§§ 50-57.)
5. Special provisions relating to liquor. (§§ 60-67.)
6. Special provisions relating to wine. (§§ 75-84.)
7. Special permits. (§§ 90-99.)
8. General provisions. (§§ 100-130.)
9. Local option. (§§ 140-147.)
10. Miscellaneous provisions; laws repealed; time of taking effect. (§§ 150-153.)

* * *

§ 102. **General prohibitions and restrictions.** 1. (a) No person shall send or cause to be sent into the state any letter, postcard, circular, newspaper, pamphlet or publication of any kind containing an advertisement or a solicitation of any order for any liquors and/or wines,

unless such person shall be duly licensed hereunder to traffic in liquors and/or wines, as the case may be.

(b) No person shall issue or publish or cause to be issued or published in the state any letter, postcard, circular, newspaper, pamphlet or publication of any kind containing an advertisement or a solicitation of any order for any liquors and/or wines, unless such person shall be duly licensed hereunder to traffic in liquors and/or wines, as the case may be.

(c) No liquors and/or wines shall be shipped into the sate, unless the same shall be consigned to a person duly licensed hereunder to traffic in liquors and/or wines, as the case may be.

(d) No common carrier or other person shall bring or carry into the state any liquors and/or wines, unless the same shall be consigned to a person duly licensed hereunder to traffic in liquors and/or wines, as the case may be.

(e) Subdivisions (c) and (d) hereof shall apply to liquors and/or wines, either in the original package or otherwise, whether intended for personal use, as well as otherwise, and to interstate, as well as intrastate, shipments or carriage.

2. No person holding any license hereunder shall knowingly employ in connection with his business in any capacity whatsoever, any person who has been convicted of a felony, or any of the following misdemeanors, or offenses, to wit:

(a) Illegally using, carrying or possessing a pistol or other dangerous weapon;

(b) Making or possessing burglar's instruments;

(c) Buying or receiving stolen property;

(d) Unlawful entry of a building;

(e) Aiding escape from prison;

(f) Unlawfully possessing or distributing habit forming narcotic drugs;

(g) Violating subdivisions six, eight, ten or eleven of section seven hundred twenty-two of the penal law; or

(h) Vagrancy.

3. No licensee shall purchase or agree to purchase any liquors and/or wines from any person within the state who is not duly licensed to sell liquors and/or wines as the case may be, at the time of such agreement and sale nor give any order for liquors and/or wines to any individual who is not the holder of a solicitor's permit.

4. No licensee or any of his or its agents, servants or employees shall peddle any liquor and/or wine from house to house by means of a truck or otherwise, where the sale is consummated and delivery made concurrently at the residence or place of business of a consumer. This subdivision shall not prohibit the delivery by a licensee to consumers, pursuant to sale made at the place of business of said licensee.

5. No licensee shall employ any canvasser or solicitor for the purpose of receiving an order from a consumer for any liquor and/or wine at the residence or place of business of such consumer, nor shall any licensee receive or accept any order, for the sale of any liquor and/or wine, which shall be solicited at the residence or place of

business of a consumer. This subdivision shall not prohibit the solicitation by a wholesaler of an order from any licensee at the licensed premises of such licensee.

6. No liquor and/or wine shall be released for delivery from any warehouse located within the state, except upon a permit having first been obtained as provided by this chapter. Applications for such permits may be filed at the office of the liquor authority in New York, Albany or Buffalo, whichever is nearest to the location of the warehouse, and shall be upon a form to be prepared by the liquor authority. This provision shall not apply to liquor and/or wine, which is to be released for shipment outside of the state.

7. Each person owning or operating any warehouse located within the state shall keep and maintain as part of his permanent records, treasury department forms fifty-two and fifty-two-a as heretofore required by the United States government.

* * *

27 U.S.C.A. § 122

United States Code Annotated
Title 27. Intoxicating Liquors
Chapter 6. Transportation in Interstate Commerce

§ 122. Shipments into States for possession or sale in violation of State law

The shipment or transportation, in any manner or by any means whatsoever, of any spirituous, vinous, malted, fermented, or other intoxicating liquor of any kind from one State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, into any other State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, or from any foreign country into any State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, which said spirituous, vinous, malted, fermented, or other intoxicating liquor is intended, by any person interested therein, to be received, possessed, sold, or in any manner used, either in the original package or otherwise, in violation of any law of such State, Territory, or District of the United States, or place noncontiguous to but subject to the jurisdiction thereof, is prohibited.

(Mar. 1, 1913, c. 90, § 1, 37 Stat. 699, Aug. 27, 1935, c. 740, § 202(b), 49 Stat. 877.)

HISTORICAL AND STATUTORY NOTES

Codifications

Credit originally appeared without a section designation, as Act Mar. 1, 1913, c. 90, 37 Stat. 699, which originally

consisted of a single undesignated section. The section 1 designation was added due to the addition of further sections 2 and 3 to c. 90 by Pub.L. 106-386, which are classified to sections 122a and 122b of this title, respectively.

Amendments

1935 Amendments. The language of this section was reenacted without change by Act Aug. 27, 1935, c. 740, § 202(b), 49 Stat. 877.

Short Title

1913 Acts. The Act of Mar. 1, 1913, c. 90, cited to the text was entitled "An Act divesting intoxicating liquors of their interstate character in certain cases," and is known as the "Webb-Kenyon Act." The Act having been returned by the President with his objections thereto, to the Senate, in which it originated, was passed by a two-thirds vote of that body and sent by it to the House of Representatives which passed the same by a two-thirds vote, whereupon it became a law by virtue of Art. I, § 7, of the Constitution of the United States.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JUANITA SWEDENBURG, in her own capacity and as proprietor of SWEDENBURG WINERY, a Virginia partnership; DAVID LUCAS, in his own capacity and as proprietor of THE LUCAS WINERY, a California sole proprietorship; PATRICK FITZGERALD; CORTES DeRUSSY; and ROBIN BROOKS;	No. ___
Plaintiffs,	
-against-	**COMPLAINT**
EDWARD F. KELLY, Chairman, and LAWRENCE J. GEDDA and JOSEPH ZARRIELLO, Commissioners, of the State Liquor Authority, Division of Alcoholic Beverage Control, State of New York, in their official capacities,	
Defendants.	

INTRODUCTION

1. This is a civil rights action seeking declaratory and injunctive relief to vindicate economic liberty, consumer freedom, and freedom of speech. Two of the five plaintiffs are small wineries operating outside the State of New York that are prohibited under state law from selling or shipping wines directly to New York that are prohibited under state law from selling or shipping wines directly to New York residents, or from advertising their products

within the State of New York. The other three plaintiffs are New York consumers who would like to purchase wines from the plaintiff producers but are prevented from doing so by New York law. The statutory regime that separates willing producers from willing purchasers is discriminatory and is intended and has the effect of protecting certain economic interests from competition from out-of-state enterprises. It therefore violates the fundamental rights of American citizens to free commerce, privileges and immunities, and freedom of speech.

JURISDICTON AND VENUE

2. This case is brought pursuant to 42 U.S.C. §§ 1983 and 1988, and 28 U.S.C. § 2201. Subject matter jurisdiction is based on 28 U.S.C. §§ 1331 and 1343(a)(3) and (4).

3. Venue is appropriate pursuant to 28 U.S.C. § 1391(b).

FACTUAL ALLEGATIONS

Parties

4. Plaintiff Juanita Swedenburg is a citizen of the United States, a resident of the Commonwealth of Virginia, and proprietor of Swedenburg Winery, a Virginia partnership. Swedenburg Winery has been in business since 1987.

5. Plaintiff David Lucas is a citizen of the United States, a resident of the State of California, and proprietor of The Lucas Winery, a California sole proprietorship. The Lucas Winery has been in business since 1978.

6. Plaintiff Patrick Fitzgerald is a citizen of the United States and resides in Elmira, New York.

7. Plaintiff Cortes DeRussy is a citizen of the United States and a resident of Bronxville, New York.

8. Plaintiff Robin Brooks is a citizen of the United States and a resident of New York, New York.

9. Defendants Edward F. Kelly, Lawrence Gedda, and Joseph Zarriello are commissioners of the State Liquor Authority, Division of Alcoholic Beverage Control, State of New York. They are sued in their official capacities. The State Liquor Authority is the agency of the State of New York responsible for issuing all licenses and permits for the manufacture, distribution, and sale of alcoholic beverages and for ensuring compliance with the Alcoholic Beverage Control Law. (*See* N.Y. Alco. Bev. Cont. Law § 10.)

10. At all times alleged herein, defendants and their agents have acted under color of state law.

The Unconstitutional Statutory Scheme

11. N.Y. Alco. Bev. Cont. Law § 102(1)(c) provides, *inter alia*, that "No alcoholic beverages shall be shipped into the state unless the same shall be consigned to a person duly licensed hereunder to traffic in alcoholic beverages. This prohibition shall apply to all shipments of alcoholic beverages into New York state and includes importation or distribution for commercial purposes, for personal use, or otherwise, and irrespective of whether such alcoholic beverages were purchased within or without the state. . . ." The provision makes an exception for certain alcoholic purchases for personal use made outside

the United States and shipped by the purchaser to him or herself.

12. N.Y. Alco. Bev. Cont. Law § 102(1)(d) provides, *inter alia*, that "No common carrier or other person shall bring or carry into the state any alcoholic beverages, unless the same shall be consigned to a person duly licensed hereunder to traffic in alcoholic beverages. . . ."

13. N.Y. Alco. Bev. Cont. Law § 102(1)(a) states that "No person shall send or cause to be sent into the state any letter, postcard, circular, newspaper, pamphlet, order kit, order form, invitation to order, price list, or publication of any kind containing an advertisement or a solicitation of any order for any alcoholic beverages, irrespective of whether the purchase is made or to be made within or without the state, or whether intended for commercial or personal use or otherwise, unless such person shall be duly licensed hereunder to traffic in alcoholic beverages.

14. N.Y. Alco. Bev. Cont. Law § 102(3-b) forbids retail licensees from purchasing or receiving alcoholic beverages except from duly licensed persons.

15. N.Y. Alco. Bev. Cont. Law § 130(1) provides that the illegal sale of alcohol is a misdemeanor punishable by prescribed fine or imprisonment.

16. N.Y. Alco. Bev. Cont. Law § 130(3) provides that other violations of the Alcoholic Beverage Control Law constitute a misdemeanor.

17. Licensed wineries in New York State are not subject to the restrictions of N.Y. Alco. Bev. Cont. Law §§ 102(a)-(c) (collectively, the "Direct Shipment and Advertising Ban").

18. Plaintiff wineries, although licensed to produce and sell wine in their own states, are not eligible for licensure in the State of New York. They are therefore subject to the Direct Shipment and Advertising Ban.

19. The Direct Shipment and Advertising Ban, combined with N.Y. Alco. Bev. Cont. Law § 102(3-b), create a monopoly by which licensed wholesales have the exclusive authority under state law to import or distribute wines from out-of-state wineries for purchase by New York residents.

The Unjust Impact of the Unconstitutional Direct Shipment and Advertising Ban on Producers and Consumers

20. Plaintiff wineries each produce a small amount of wine each year. Few wineries of such small size are represented by wine wholesalers by reason of economies of scale. Like most small wineries, plaintiff wineries sell the vast majority of their wine to customers who visit their wineries from around the country, and by direct shipment to their customers in their own states and around the country. Absent direct sale and shipment of wines to consumers, the plaintiff wineries would cease to operate as viable business enterprises.

21. The plaintiff wineries are not represented by wholesalers in New York. The operation of the Direct Shipment and Advertising Ban therefore has the effect of preventing plaintiff wineries of the opportunity to sell wines in the State of New York.

22. The State of New York has enforced the Direct Shipment and Advertising Ban through sting operations, fines, and other means.

23. The winery plaintiffs all have New York customers who would like to order their products. The winery plaintiffs would sell and ship products to New York customers but do not do so because of the Direct Shipment and Advertising Ban.

24. Licensed New York wineries may sell their wines directly to New York customers; they may offer tastings to the public; they may ship wine directly to New York customers; and they may ship wine to customers from other licensed New York wineries.

25. The winery plaintiffs would like to send brochures, wine lists, order forms, or other advertisements to New York customers but do not do so because of the Direct Shipment and Advertising Ban.

26. Plaintiff David Lucas maintains a nationwide mailing list of customers, including New York customers. He also maintains an internet Website where he posts information about his winery and his wines. Through this mailing list, the Internet, and other means, plaintiff Lucas has advertised and otherwise provided information about his wines to residents of New York. He cannot lawfully send advertisements to New York customers because of the Direct Shipment and Advertising Ban.

27. Plaintiff Juanita Swedenburg includes a brochure, wine list, order form or other advertisement for her wines in packages of wine that she ships to customers. She has past and possible future customers in New York and would like to send those customers her brochure, wine

lists, order form, or other advertisement, but she cannot because of the Direct Shipment and Advertising Ban.

28. Licensed New York wineries may send brochures, wine lists, order forms, and other advertisements directly to New York customers.

29. The consumer plaintiffs are wine enthusiasts who desire to purchase wine directly from out-of-state wineries and/or through Internet retailers. One or more of them have purchased wine via the Internet or direct mail.

30. Because the Direct Shipment and Advertising Ban prohibits common carriers from delivering wine shipments directly to consumers from non-licensed producers or retailers, New York residents including the consumer plaintiffs cannot visit out-of-state wineries, including plaintiff wineries, and ship the wines back to themselves.

31. In January 2000, the consumer plaintiffs each ordered wines from the one or more of the plaintiff wineries, supplying a copy of their drivers' licenses to demonstrate that they are legal adults, providing credit card information, and requesting direct delivery of the wines. Although the plaintiff wineries were prepared to sell the wine to the consumer plaintiffs, in each instance the orders were denied on the sole ground that the sale and shipment would violate the Direct Shipment and Advertising Ban. The orders and responses are attached as Exhibit A to this Complaint.

FIRST CAUSE OF ACTION
(VIOLATION OF INTERSTATE COMMERCE CLAUSE)

32. The allegations contained in paragraphs 1-31 are incorporated by reference as if fully set forth herein.

33. The interstate commerce clause, U.S. Const. art. 1, sec. 8, cl. 3, creates open national markets and prohibits discriminatory trade legislation among the states.

34. The Direct Shipment and Advertising Ban discriminates on its face against out-of-state wineries, and in favor of New York wineries, by prohibiting direct sales and shipments of wines to New York consumers from out-of-state wineries and by permitting such direct sales and shipments to New York consumers by licensed in-state wineries.

35. Defendants have no adequate justification for maintaining such discrimination.

36. A principal purpose of the Direct Shipment and Advertising Ban is economic protectionism, primarily or exclusively for the benefit of wholesalers. That purpose is not a valid justification for discriminatory trade barriers under the interstate commerce clause.

37. The discriminatory Direct Shipment and Advertising Ban prevents the plaintiff wineries from selling and shipping wines directly to New York consumers, including the consumer plaintiffs; and prevents the consumer plaintiffs from obtaining desired wines from out-of-state producers, including plaintiff wineries.

38. Accordingly, the Direct Shipment and Advertising Ban violates the rights of all the plaintiffs to freedom

of commerce as guaranteed by the interstate commerce clause.

SECOND CAUSE OF ACTION (VIOLATION OF PRIVILEGES AND IMMUNITIES CLAUSE)

39. The allegations contained in paragraphs 1-38 are incorporated by reference as if fully set forth herein.

40. The privileges and immunities clause embodied in U.S. Const. art. 4, sec. 2, cl. 1 states, "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several states."

41. The freedom to pursue a livelihood is a fundamental right protected by the privileges and immunities guarantee.

42. The Direct Shipment and Advertising Ban prevents plaintiffs Swedenburg and Lucas from directly selling and shipping wines to New York consumers. Absent the prohibition, the winery plaintiffs would sell and ship wines to New York consumers.

43. Because nearly all the winery plaintiffs' sales are directly to consumers, the Direct Shipment and Advertising Ban significantly impairs plaintiffs' ability to pursue their chosen and legitimate livelihood.

44. The opportunities available to plaintiffs Swedenburg and Lucas to sell and ship wine directly to New York consumers are severely disadvantageous relative to the opportunities available to similarly situated New York wineries, by virtue of the Direct Shipment and Advertising Ban.

45. No adequate justification exists to deny plaintiffs Swedenburg and Lucas the opportunities to directly ship and sell wine to New York consumers that are available to New York wineries.

46. Accordingly, the Direct Shipment and Advertising Ban violates the economic liberty of plaintiffs Swedenburg and Lucas under the privileges and immunities guarantee.

THIRD CAUSE OF ACTION
(VIOLATION OF FIRST AMENDMENT)

47. The allegations contained in paragraphs 1-46 are incorporated by reference as if fully set forth herein.

48. The First Amendment to the United States Constitution, applied to the states through the 14th Amendment, prohibits the states from making any law abridging freedom of speech.

49. The Direct Shipment and Advertising Ban, on its face, prohibits in the most sweeping terms truthful information and advertising about wine, including but not limited to commercial speech.

50. The Direct Shipment and Advertising Ban subjects to misdemeanor liability any person who advertises out-of-state wines in any manner whatsoever, including over the Internet. By its terms, the Direct Shipment and Advertising Ban even forbids speech inviting New York residents to visit out-of-state wineries where they may lawfully taste and purchase the products.

51. Plaintiff Lucas has advertised and otherwise provided information about their wines to residents of

New York through mailings, the Internet, and other means. Plaintiffs Lucas and Swedenburg desire to and would advertise and otherwise provide information about their wines to residents of New York through mailings, the Internet, and other means.

52. Consumer plaintiffs Fitzgerald, DeRussy, and Brooks have secured information, and desire to secure further information, including ordering information, about wines from out-of-state wineries and over the Internet.

53. The Direct Shipment and Advertising Ban exerts a chilling effect on protected speech, and on its face forbids certain protected speech. No adequate justification exits for this censorship of speech.

54. Accordingly, the Direct Shipment and Advertising Ban violates the right of the winery plaintiffs to produce, and of the consumer plaintiffs to receive, protected speech in violation of the First Amendment.

REQUEST FOR RELIEF

For the foregoing constitutional violations, the plaintiffs respectfully request that this honorable Court:

A. Declare that N.Y. Alco. and Bev. Cont. Law §§ 102(1)(a), (c), and (d) are unconstitutional, void, and of no effect;

B. Preliminarily and permanently enjoin defendants from enforcing N.Y. Alco. and Bev. Cont. Law §§ 102(1)(a), (c), and (d);

C. Award reasonable attorney fees pursuant to 42 U.S.C. § 1988; and

D. Order such further relief as to the Court seems just and proper.

Dated: New York, New York
February 3, 2000

Clint Bolick
William H. Mellor III
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– and –

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Attorneys for Plaintiffs

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

JUANITA SWEDENBURG, in her own capacity and as proprietor of SWEDENBURG WINERY, a Virginia partnership; DAVID LUCAS, in his own capacity and as proprietor of THE LUCAS WINERY, a California sole proprietorship; PATRICK FITZGERALD; CORTES DeRUSSY; and ROBIN BROOKS;

Plaintiffs,

-against-

EDWARD F. KELLY, Chairman, LAWRENCE J. GEDDA and JOSEPH ZARRIELLO, Commissioners, of the State Liquor Authority, Division of Alcoholic Beverage Control, State of New York, in their official capacities,

Defendants,

and

CHARMER INDUSTRIES, INC., PEERLESS IMPORTERS, INC., EBER BROTHERS WINE & LIQUOR CORP., PREMIER BEVERAGE COMPANY LLC, METROPOLITAN PACKAGE STORE ASSOCIATION, INC., LOCAL 2D OF THE ALLIED FOOD AND COMMERCIAL WORKERS INTERNATIONAL UNION, and DR. CALVIN BUTTS,

Intervenor-Defendants.

Case No.
00 CV 778 (RMB)

Exhibit A to Plaintiffs' Notice of Motion for Summary Judgment, dated June 7, 2001 – Affidavit of Juanita Swedenburg, sworn to on May 22, 2001

AFFIDAVIT OF JUANITA SWEDENBURG

CITY OF MIDDLEBURG)
) SS.
STATE OF VIRGINIA)

Juanita Swedenburg, being first duly sworn, upon oath, states as follows:

1. I am a citizen of the United States, a resident of the State of Virginia, and over 18 years of age. I am a plaintiff in this action. I make this affidavit based on my personal knowledge of the facts set forth and am competent to testify thereto if called as a witness at trial.

2. I am a proprietor of Swedenburg Winery, a Virginia partnership. Swedenburg holds an Virginia ABC license and a BATF license to produce and sell wine.

3. Swedenburg Winery opened to the public in the spring of 1988, but there was a great deal of work and preparation that took place before the formal opening. Beginning around 1986, I started studying and attending classes on winemaking and related lab work. I attended seminars at Cornell University, Pennsylvania State University, and Ohio State University on different aspects of winemaking, studying red wine production, aromas, enzymes, blending, Rieslings, and Chardonnays, among other subjects. I continue to attend similar seminars and roundtables to this day.

4. Before beginning construction of Swedenburg Winery in 1987, we spent time securing a loan, getting plans

made, finding a builder, and going through the examination processes for receiving federal and state licenses. Once we built the winery, we hired a consultant who helped us through our first couple of winemaking seasons until we had gained enough first-hand experience to run the winery on our own, as we do today.

5. Swedenburg is a small winery, producing approximately 1,500-2,000 cases of wine a year. (A case is a box of 12 bottles.) We started out producing a Riesling and a Chantilly, and our Chardonnay was ready about eight months after we opened. Today, we have four whites and three reds ranging in price from $10 to $15. We have won over 200 awards at international wine competitions, including Amenti Delvino (Cromwell, CT), Indiana State Fair, State Fair of Virginia (Charlottesville, VA), American Wine Society, Beverage Tasting Institute (Chicago, IL), Dixie Classic (Durham, NC), Virginia Governor's Cup (Richmond, VA), Homestead Wine Competition, San Diego Wine Competition, National Orange Show (Riverside, CA), Vinifera Winegrowers' Association (Lansdowne, VA).

6. We sell the vast majority of our wine – approximately 90-95 percent – to visitors to the winery. In the year 2000, we had approximately 6,000 visitors, and in 1999, we had approximately 5,500 visitors. About half our visitors are people who live outside the state of Virginia.

7. Since the direct shipping laws have become a focus of popular attention and more people are aware of the bans on direct shipping, we do not receive as many direct shipping requests as we used to, especially from customers outside the state. The majority of our direct shipping is now to customers within Virginia. As a result of all the publicity about the direct shipping bans that exist across the country and

the existence of the bans themselves, our direct shipping sales have declined from approximately ten orders a month to approximately one order a month. We require a minimum order of 12 bottles per shipment because shipping is so expensive.

8. If we did not have out of state visitors, we could not manage. There is not enough consumption of Virginia wines within Virginia for us to survive without selling to out of state people.

9. In March, I had a call from someone in New York who said he was a previous customer of ours. I asked him how he found out about us and he said that he had been to the winery and bought wine from us in the past. He was asking for current prices and about shipping. I told him we could not ship to him because of New York's direct shipping ban, but I invited him to come visit the winery.

10. Swedenburg Winery would be sending brochures and price lists to New York if not for the New York law. I have given printed information about our wines to New York residents who have visited the winery, and if not for this lawsuit, I would have mailed a Swedenburg wine list to the New York customer who called in March. I send out our wine list all the time and include it every time I ship wine to a customer because it has the directions to our winery, descriptions and prices of the wines, and our phone number.

11. Swedenburg Winery does not have a wholesaler in New York or any other state and our wines are not carried in any state other than Virginia; our sales to out of state customers are all direct. Years ago, we had a wholesaler in Virginia, but the relationship was not helpful or valuable. The wholesaler sold no more than ten cases of our wine a year, and I would have to go recover wines from him every so often in order to

keep him from selling old vintages. We are just too small for a relationship with a wholesaler to be worthwhile.

12. However, I know there are people in New York who would like to buy our wine. In January 2000, I received a letter from New York resident Robin Brooks asking me to ship her some wine. She enclosed a copy of her driver's license as proof of her age. I wrote her back that I could not fill her order because of New York's direct shipping ban.

13. We see a great many visitors to the winery who come from New York and carry wine back with them to New York. We would ship directly to these New York customers if not for the New York law banning such shipments. We have also had New York customers in the past, but customers are like babies – they have to be taken care of. If you tell them no or that they cannot have something, as we have to do because of New York's direct shipping ban, they are gone.

14. The only reason I did not ship wine to New York resident Robin Brooks when she placed an order in January 2000 and the only reason I cut off the New York customer who called in March is the New York direct shipping ban. Can you imagine running a business where when a customer asks about buying your product, you have to tell them to get lost? But that is exactly what I have to do because of the archaic New York laws. They are completely out of step with modern times.

/s/ Juanita G. Swedenburg
Juanita Swedenburg

Subscribed and sworn before me this
22nd day of May 2001.

Notary Public, City of Middleburg,
County of [ILLEGIBLE] State of Virginia.

/s/ Hilda G. Pleece
Notary Public

My Commission expires 8-31-01

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Exhibit P to Plaintiffs' Notice of Motion for Summary Judgment, dated June 7, 2001 – Affidavit of John Dyson, sworn to on May 24, 2001

AFFIDAVIT OF JOHN DYSON

CITY OF NEW YORK)
) SS.
STATE OF NEW YORK)

John Dyson, being first duly sworn, upon oath, states as follows:

1. I am adult citizen, residing in Manhattan. I make this affidavit based upon my personal knowledge of the facts stated herein.

2. I am the majority owner of Millbrook Winery in Millbrook, NY. I also own, with partners, a vineyard and winery in California, a vineyard and winery in Italy, and an investment firm.

3. I received a Bachelor of Science degree from the College of Agriculture at Cornell University in 1965. I earned a Master of Public Affairs degree from the Woodrow Wilson School at Princeton University in 1967.

4. In addition to my career in the private sector, I have held a number of positions in state and local government. In 1975, I was appointed Commissioner of Agriculture for the State of New York by Governor Hugh Carey.

From 1976-79, I served as Commissioner of Commerce for the State of New York. Subsequently, Governor Hugh Carey and Governor Mario Cuomo appointed me to the New York Power Authority. From 1994-96, I served as Deputy Mayor for Economic Development and Finance for the City of New York under Mayor Rudolph Giuliani.

5. In 1979, I bought acreage in Millbrook, NY, and, subsequently, I experimented with grapes with the goal of opening a winery if the property yielded a good crop. My first crop was harvested in 1982 and the wine was produced in a garage. It was a success. Thereafter, I planted additional property for a total of five acres, and Millbrook Winery produced its first commercial vintage wines in 1985. Initial production totaled approximately 500 cases.

6. Today, Millbrook Winery produces approximately 12,000 cases annually, mostly from grapes grown on my farm. We grow mostly Chardonnay, Tocai Friulano, and Cabernet Franc grapes.

7. Millbrook Winery holds a winery permit from the U.S. Bureau of Alcohol, Tobacco, and Firearms (Exh. A), which authorizes it "to sell, offer or deliver for sale, contract to sell or ship, in interstate or foreign commerce," the wine we produce. It also holds a "Winery/Farm Winery Retail License" (Exh. B) from the State of New York. Millbrook Winery is bonded (Exh. C) to ensure payment of taxes to the State of New York and the Federal Government.

8. I am active in the Wine Grape Foundation, the principal trade association for New York wineries. The New York wine industry has grown into one of the nation's most vibrant. There are approximately 140 wineries in the State of New York, concentrated in four major wine

regions: Long Island, Hudson Valley, the Finger Lakes, and Lake Erie. All of the wineries except Canandiagua are small.

9. Tourists are a significant factor in all of the State's wine-producing regions. Many tourists are drawn by the wineries themselves, while others discover New York wineries while visiting other attractions in those regions. Many of the tourists visit from other states and countries.

10. While I was Agriculture Commissioner, the State of New York passed farm winery legislation, allowing farm wineries to sell wine directly to members of the public on weekends. The law was designed to help stimulate small wineries. It was necessary because wines from small New York wineries are often difficult to find in retail establishments, particularly outside the State of New York. As a result, any customers would not be able to purchase New York wines unless the wineries could sell it directly to their customers. Moreover, a large percentage of sales occur at the point of contact, after a customer has tasted wines on the winery premises.

11. Under New York law, farm wineries also may operate one retail establishment in New York State to sell their wines.

12. The benefits of farm winery status accrue only to wineries below a certain size. Many if not most New York wineries are farm wineries.

13. All New York wineries also may ship directly to customers within the State of New York, including restaurants and retailers. A Prohibition-era law forbidding credit was repealed, so that New York wineries can take orders

using credit cards and ship wine to their customers without a face-to-face transaction.

14. Millbrook Winery has been quite extensively selling and shipping directly to New York consumers since the 1980s. We maintain a website and customers can order wine on-line. Direct sales and shipments are a vital part of our business. In 1999, we shipped 2,984 packages of one or more bottles to New York consumers. In 2000, we shipped 3,179 packages. Most of the shipping is provided by United Parcel Service. We sell and ship directly to both individual consumers and restaurants.

15. We require a check or credit card for all orders, and a signature of someone 21 years of age or older to receive all shipments. Additionally, all packages contain a sticker indicating the adult signature requirement, and no packages are left without a signature. Over nearly two decades, we have shipped tens of thousands of packages to New York consumers. During that time, I am not aware of a single problem or complaint concerning shipments to underage purchasers. Reports of minors ordering wine in the context of "sting" operations simply do not happen often, if at all, in the real world.

16. The procedures we use to prevent underage access are not required by New York law, to my knowledge. Our procedures in that regard have never been a focus of attention from the New York State Liquor Authority.

17. Until recently, Millbrook Winery used a New York Wholesaler, Lauber Imports, to sell some of its products in the State of New York. We discontinued that relationship because it was expensive and inefficient. The markup added by wholesalers averages between $20 and

$40 per case, whereas we can ship wine for approximately four dollars per case. The cost difference between distributing through wholesalers and shipping directly produces lower prices and/or greater profits. At the same time, growing consolidation in the wholesaler industry means that most wholesalers pay less attention to small wineries, whose products are often lost amidst an ever-growing array of wineries in their "book." Wholesalers have every incentive to cater to their larger suppliers.

18. As a result, about a year and a half ago, Millbrook Winery decided to discontinue its relationship with a New York wholesaler. We now sell and distribute all of our wines directly to retail and individual customers. As a consequence, we have been able to reduce costs and increase profits, as well as lowering the price for our customers.

19. A substantial potential out-of-state market exists for New York wines, attested by the large number of tourists who purchase wines from New York wineries and the large number of requests for direct shipments from out-of-state customers. Millbrook Winery used to sell and ship directly to out-of-state customers until states started cracking down on such shipments. We no longer sell and ship directly to out-of-state customers. The out-of-state sales had been very profitable because they were at the retail as opposed to the wholesale price. Curtailing them reduced profits by 13 percent and led to reduced employment.

20. We maintain agreements with wholesalers in approximately one dozen states. It is an expensive, cumbersome, and inefficient process. Because wholesalers typically do not market wines from small producers, the

winery must send representatives to cultivate orders from retailers or restaurants. But the winery cannot take the order; we must refer the customer to a wholesaler. The wholesaler usually will not agree to carry a wine unless the winery offers a "program," i.e, a price discount. We have to do all of the sales work. The wholesaler adds nothing to the enterprise except distribution, which we could do more cheaply and efficiently. The process is so expensive and unwieldy that Millbrook Winery is effectively shut out of more than half the states. Given that most New York wineries are even smaller, the effect of the three-tier system on them is even greater.

21. This effect would be reduced greatly if New York would allow out-of-state wineries to ship directly to New York consumers on a reciprocal basis. Approximately one dozen states offer reciprocity to states that allow direct shipping into their states. Reducing trade barriers would open enormous outlets for New York wineries to sell their products.

22. My California winery, Williams & Selyem, depends on out-of-state direct shipments for about a third of its business. It also is creating a website advertising its products. Approximately 95 percent of its sales are directly to customers in states to which we are allowed to ship.

23. Different rules exist governing sales and shipments of wines in the states into which we are allowed to ship directly to consumers. Generally, they are easy to navigate. We are careful to follow the laws in other states because our federal license is at stake, and now states have the authority to enforce their laws in federal court. Williams and Selyem collects a .60 per gallon wine tax and a seven percent of retail price sales tax on wine shipped

into Rhode Island. Williams and Selyem collects a .40 wine tax (on wines .5% to 14%) and a .75 wine tax (on wines 14.1% to 22%) as well as a sales tax (paid on the county tax rate where the wine is shipped) on wines shipped to Nevada. Williams and Selyem collects an 8% sales tax based on the retail price of the wine less shipping charges on wines shipped to New Hampshire. Williams and Selyem collects a .40 (for 14% or less) and .67 (for over 14%) wine tax on wine shipped into Georgia. No wine or sales tax is paid on wine shipped to reciprocal states.

24. No license exists in New York for out-of-state wine producers to sell or ship wine to New York consumers.

25. A large potential market exists for out-of-state wineries that are not represented by New York wholesalers. The impact is not necessarily on the total volume of wine imported into New York, but on the producers whose wine is sold. Relatively few out-of-state wineries are handled by the major New York wholesalers. It would be uneconomical, if not impossible, for wholesalers to represent all out-of-state wineries; particularly wineries that produce a small volume of wines. Only specialty wholesalers will carry them, if any wholesalers will; and it is not easy for consumers to find them. California alone has several hundred wineries, most of which produce small volumes of wine. The current system effectively prevents them from selling their wine in New York. Only through direct sales would the New York market be open to them. Multiply that impact several hundred-fold and we can begin to understand the impact of New York's direct shipment prohibition on interstate commerce in general and small family-owned wineries in particular.

26. If other out-of-state wineries were allowed to ship to New York, they easily could abide the same requirements that New York wineries must follow in shipping directly to retailers and other consumers within New York. Sales taxes can be easily collected and other requirements are not onerous.

27. Any suggestion that elimination of the direct shipment prohibition would harm New York wineries is nonsense. The wholesaler laws were not put in place for the benefit of New York wineries. We have nothing to fear from greater ease of entry into the New York market. Abundant competition already exists. Rather, New York wineries are shut out of out-of-state markets and thus are losing sales because of our own state's protectionist laws.

28. Out-of-state markets offer huge potential to New York wineries. Tens of thousands of consumers are favorably exposed to New York wines every year. Before various states started cracking down on out-of-state direct shipments, New York wineries sold a great deal of wine directly to out-of-state consumers. As a result of New York's own trade barriers, those out-of-state markets have all but disappeared.

29. The purpose of New York's law is to protect the middleman. In most other industries, distributors have largely disappeared because they are expensive and inefficient. They are demonstrably so here, having the perverse effect of limiting access to markets for small wineries rather than facilitating them. The New York law operates solely for the benefit of wholesalers.

30. Given my experience from multiple perspectives, I can attest that eliminating the requirement that out-of-state wineries may distribute their wine only through

wholesalers, thereby allowing direct sales and shipments of wine from out-of-state producers to New York consumers, would benefit out-of-state wineries, New York wineries, especially, and consumers. The prohibition as it now stands is pure protectionism for the benefit of wholesalers, and to the detriment of everyone else involved in the process.

/s/ John A. Dyson
John Dyson

Subscribed and sworn before me this
24 day of May 2001.

Notary Public, City of New York,
State of New York.

/s/ Maureen Webb
Notary Public

My Commission expires___.

MAUREEN WEBB
Notary Public, State of New York
No. 01WE6024321
Qualified in Kings County
Commission Expires 5/10/03

Exhibit A to Dyson Affidavit –
Millbrook Winery permit
from the U.S. Bureau of
Alcohol, Tobacco and Firearms

DEPARTMENT OF THE TREASURE – BUREAU OF ALCOHOL, TOBACCO AND FIREARMS	1. PERMIT NUMBER NY-W-126
	2. DATE OF PERMIT October 29, 1985

BASIC PERMIT (Under Federal Alcohol Administration Act)	3. REGISTRY NO. (if applicable) BW-NY-716
	4. DATE OF APPLICATION FOR AMENDMENT September 2, 1998
5. NAME AND ADDRESS OF PERMITTEE (Number and street, city or town, State and ZIP Code) MILLBROOK WINERY, INC. T/A MILLBROOK VINEYARDS T/A VERAISON WINE CELLARS T/A MILLBROOK VINEYARDS & WINERY T/A WILLIAMS & SELYEM WINERY R.R. #1, BOX 167D MILLBROOK, NEW YORK 12545	[SEAL]
6. TRADE NAME AUTHORIZED BY THIS PERMIT (Trade name approval does not constitute approval as a brand name for labeling purposes. If needed, list on reverse or use continuation sheet.) Mistral Williams & Selyem Millbrook Vineyards & Winery	

7. PERMIT GRANTED FOR (ONE TYPE OF OPERATION ONLY).

Pursuant to the application of the data indicated in item 4, you are authorized and permitted to engage, at the above address, in the business of:

a. ☐ Distilled Spirits– ☐ distiller ☐ rectifier (processor) ☐ warehouseman and/or ☐ warehouseman and bottler and while so engaged, to sell, offer or deliver for sale, contract to sell or ship, in interstate or foreign commerce, the distilled spirits so distilled or rectified, or warehoused and bottled, or the wines so rectified.

b. ☒ Wine – ☒ producer and blender ☐ blender and while so engaged, to sell, offer or deliver for sale, contract to sell or ship, in interstate or foreign commerce, the wine so produced or blended,

c. ☐ Importer – importing into the United States the following alcoholic beverages: and while so engaged, to sell, offer to deliver for sale, contract to sell or ship, in interstate or foreign commerce, the alcoholic beverages so imported.

d. ☐ Wholesaler – Purchasing for resale at wholesale the following alcoholic beverages: and while so engaged, to receive or to sell, offer or deliver for sale, contract to sell or ship, in interstate or foreign commerce, the alcoholic beverages so purchased.

This permit is conditioned upon your compliance with the Federal Alcohol Administration Act; the Twenty-First Amendment and the laws relating to its enforcement; all other Federal laws relating to distilled spirits, wine, and malt beverages, including taxes with respect to them; the Federal Water Pollution Control Act; and, all applicable regulations made pursuant to law which are now, or may hereafter be, in force.

This basic permit is effective from the date shown above and will remain in force until suspended, revoked, annulled, voluntarily surrendered, or automatically terminated.

THIS PERMIT WILL AUTOMATICALLY TERMINATE THIRTY DAYS AFTER ANY CHANGE IN PROPRIETORSHIP OR CONTROL OF THE BUSINESS, unless an application for a new basic permit is made by the transferee or permittee within the thirty day period. If an application for a new basic permit is timely filed, the outstanding basic permit will continue in effect until the application is acted on by the Regional Director (Compliance). Bureau of Alcohol, Tobacco and Firearms.

THIS PERMIT IS NOT TRANSFERABLE, ANY CHANGE IN THE TRADE NAME, CORPORATE NAME, MANAGEMENT OR ADDRESS OF THE BUSINESS COVERED BY THIS PERMIT, OR ANY CHANGE IN STOCK OWNERSHIP (MORE THAN 10%) MUST BE REPORTED TO THE REGIONAL DIRECTOR (COMPLIANCE) WITHOUT DELAY.

THIS IS AN ☐ ORIGINAL PERMIT ☒ AMENDED PERMIT

REASON FOR AMENDMENT	DATE OF AMENDMENT
Addition of labeling and operating trade name	March 23, 1999

SIGNATURE OF REGIONAL DIRECTOR (COMPLIANCE), BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

/s/ Grace K. Reynolds

by [for] James W. McMonagle, Chief, Technical Services

Exhibit B to Dyson Affidavit –
Millbrook Winery "Winery/Farm Winery
Retail License" from the State of New York

[SEAL]

WINERY/FARM RETAIL LICENSE	LICENSE EFFECTIVE 04/01/1999
20 2 DUTC WA 0052L 305	LICENSE EXPIRES 03/31/2000

NEW YORK STATE LIQUOR AUTHORITY

MILLBROOK WINERY INC WING ROAD RR 1 BOX 167D MILLBROOK NY 12545	CYCLICAL CREDIT GROUP	
	FILING FEE	25.00
	LICENSE FEE	125.00
	COUNTY	DUTCHESS
	SERIAL	00521
	CERTIFICATE NUMBER	479949

THE LICENSEE DESIGNATED ABOVE IS HEREBY GRANTED PERMISSION, UNDER THE ALCOHOLIC BEVERAGE CONTROL LAW TO TRAFFIC IN ALCOHOLIC BEVERAGES PURSUANT TO THE TYPE OF LICENSE INDICATED IN THE UPPER LEFT HAND CORNER OF THIS CERTIFICATE AND ACCORDING TO THE STATUTES AND REGULATIONS PERTAINING THERETO.

THIS LICENSE SHALL NOT BE TRANSFERABLE TO ANY OTHER PERSON OR TO ANY OTHER PREMISES OR TO ANY OTHER PART OF THE BUILDING CONTAINING SUCH LICENSED PERMISES: IT SHALL NOT BE DEEMED A PROPERTY OR VESTED RIGHT AND MAY BE REVOKED AT ANY TIME PURSUANT TO

LAW FOR ANY OF THE CAUSES PRINTED ON THE REVERSE SIDE HEREOF

EDWARD F. KELLY
CHAIRMAN

XXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXX
Chairman

* * *

IF THERE BE A DOOR OPENING FROM THE STREET INTO THE LICENSED PREMISES AND A WINDOW FACING THE STREET UPON WHICH SUCH DOOR OPENS, THIS LICENSE SHALL BE DISPLAYED IN SUCH WINDOW, SO IT MAY BE READILY SEEN FROM THE STREET.

Certificate No. F479949

Exhibit C to Dyson Affidavit –
Bond held by Millbrook Winery

EXCISE BOND UNDERWRITERS
100 WILLIAM STREET – NEW YORK, N.Y. 10038

Bond Form L-9 Prescribed by New York State Liquor Authority November 1963

BOND IN SUPPORT OF APPLICATION FOR LICENSE OR PERMIT UNDER THE NEW YORK ALCOHOLIC BEVERAGE CONTROL LAW

LIQUOR ***DUPLICATE***

014-17 X-B12623 – 25

BOND EXPIRES IN SEPTEMBER,

BOND NUMBER 05-46-176735

KNOW ALL MEN BY THESE PRESENTS, that we,	Penal Sum of Bond 10,000.00 Plus Costs
Name of Applicant	Address of Place of Business
MILLBROOK WINERY, INC.	WING ROAD MILLBROOK, NY 12545

In the county of DUTCHESS State of NEW YORK as Principal, and INSURANCE CO. OF NORTH AMERICA, having an office and usual place of business at 195 BROADWAY, NEW YORK, NY 10007

_____

_____ L.S.

Principal

INSURANCE CO. OF NORTH AMERICA

BY: _____

/s/ _____

Attorney in fact

↑

APPLICANT MUST SIGN HERE

_____

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Affidavit of Walter Hellerstein, sworn to on July 31, 2001, in Support of Defendants' Cross-Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment, dated August 17, 2001

AFFIDAVIT OF WALTER HELLERSTEIN

STATE OF GEORGIA)
) ss.
County of Clarke)

Walter Hellerstein, being duly sworn, deposes and states as follows:

1. My name is Walter Hellerstein. I give this affidavit for use by Defendants and Intervenor-Defendants in connection with the above captioned litigation. The opinions expressed are my best professional judgment relying on my experience and utilizing materials regularly and reasonably relied upon by persons in my field.

2. I am the Francis Shackelford Professor of Taxation at the University of Georgia School of Law, where I have taught since 1978. I have devoted most of my professional life to the study of state and local taxation and have written extensively about state and local taxation. My experience and scholarly work in the field of state and local taxation are reflected in my current resume, which I have attached hereto as Exhibit A.

3. I have been accepted as an expert witness on matters involving state and local taxation in *Central Telephone Co. v. North Carolina Department of Revenue*, No. 2000-5, North Carolina Department of Revenue, August 16, 2000; *Appeal of Panhandle Eastern Pipe Line Co., et al.*, Nos. 98-6865-DT, 98-6866-DT, Kansas Board of Tax Appeals, Sept. 16, 1999; *Springs Industries, Inc. v. South Carolina Department of Revenue*, No. C.A. No. 99-ALJ-17-0153-CC, South Carolina Administrative Law Judge Division, May 26, 1999; *Pennzoil Company and Subsidiaries v. Department of Revenue*, No. 4301, Oregon Tax Court, March 10, 1999; *In the Matter of the Protest of KMART Properties, Inc.*, ID No. 02-297446-00 6, Assessment Nos. 213646 and 213647, Before the Taxation and Revenue Department of the State of New Mexico, Nov. 20, 1998; *The Williams Companies Inc & Subsidiaries v. Department of Revenue of the State of Montana*, Case No. CT-1996-1, Montana State Tax Appeal Board, July 27-28, 1998; *General Motors Corporation, et al. v. Director of Revenue, State of Missouri*, Cause No. 96-001882RI, Missouri Administrative Hearing Commission, August 18, 1997; *Fleming Foods of Texas, Inc. v. Sharp*, No. 96-12390, Travis County, Texas District Court, 53rd Judicial District, March 10, 1997; *General Motors Corporation d/b/a General Motors Emissions Laboratory v. City and County of Denver*, No. 950401, Treasury Division, Department of Revenue, City and County of Denver, July 23, 1996; *In re Chrysler Corporation*, No. 40-910308-2, Philadelphia Tax Review Board, Sept. 14, 1995; *Mississippi Power & Light Co., et al. v. Mississippi State Tax Commission*, Civil Action Nos. 154,261-154,263, Chancery Court of the First Judicial District of Hinds County, Mississippi, December 13, 1994; *Peabody Coal Co. v. The Navajo Nation*, No. CIV 88-0931-PCT-BMV, United States District Court for the

District of Arizona, March 18, 1994; *Chevron U.S.A., Inc. v. Mississippi State Tax Commission*, Cause No. 148,792, Chancery Court of the First Judicial District of Hinds County, Mississippi, January 25, 1993; *H. A. True, Jr., et al. v. Tax Commissioner of the State of North Dakota*, Civil No. 38367, North Dakota District Court, South Central Judicial District, Burleigh County, October 12, 1989; *American Telephone & Telegraph Co. v. Commissioner of Revenue*, Docket Nos. 146547-146550, Massachusetts Appellate Tax Board, June 7, 1989; *J.C. Penney Co. v. City of Tacoma*, Docket No. 271861, Superior Court, Pierce County, State of Washington, March 10, 1989; *American Telephone and Telegraph Co. v. State Tax Appeal Board*, Docket No. CDV 86-823, District Court of the First Judicial District of the State of Montana, Lewis and Clark County, June 6, 1988; *Burlington Northern Railroad Co. v. Wyoming State Tax Department*, No. C-87-0252, United States District Court for the District of Wyoming, May 1, 1988; *Union Pacific Railroad Co. v. Public Utility Commission of the State of Oregon*, Civil No. 86-778-PA, United States District Court for the District of Oregon, July 13, 1987; *Kansas City Southern Railway v. McNamara*, 624 F. Supp. 395 (M.D. La. 1985); *In re Factual Issues in Cause No. 83-551 of the Supreme Court of Montana (Burlington Northern, Inc. v. Schwinden)*, District Court of the First Judicial District of the State of Montana, Lewis and Clark County, May 25, 1984; and *Alabama Great Southern Railway v. Eagerton*, 541 F. Supp. 1084 (M.D. Ala. 1982).

4. I have testified at the invitation of Committees of the United States Congress on matters involving state and local taxation in *Hearings on H.R. 1054, the "Internet Tax Freedom Act." Before the Subcomm. on Commercial and Administrative Law of the House Committee on the*

Judiciary, 105th Cong., 1st Sess. (July 17, 1997); *Hearings on the Effect of Interstate Branching on National, State, and Local Economics Before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance, and Urban Affairs*, 102d Cong., 1st Sess. (May 15, 1991), *Hearings on the Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary*, 100th Cong., 2d Sess. (Sept. 21, 1988), *Hearings on the Severance Tax Equity Act of 1982 Before the Subcommittee on Energy and Agricultural Taxation of the Senate Committee on Finance*, 98th Cong., 2d Sess. (July 24, 1984), and *Hearings on the Commerce Clause and State Severance Taxes Before the Subcommittee on Intergovernmental Relations of the Senate Committee on Government Affairs*, 97th Cong., 1st Sess. (July 15, 1981). I have testified before state legislative bodies in the following states on the following matters relating to state and local taxation: Florida, sales tax on services; Georgia, severance tax on kaolin; Louisiana, coastal wetlands environmental levy; Michigan, Single Business Tax apportionment; and Texas, criteria for a viable state tax structure. I have testified at the invitation of the Advisory Commission on Electronic Commerce created by Congress on "The Law of Sales Taxation in a Cyberspace Economy" (June 22, 1999).

5. I have consulted with states and with private industry on a wide variety of issues involving state and local taxation and related matters. My consulting activities with states include: Alaska, providing advice regarding the constitutionality of proposals to revise Alaska's oil and gas income tax and drafting substantial portions of the state's briefs in *South-Central Timber Development,*

Inc. v. Wunnicke, 467 U.S. 82 (1984); Delaware, providing advice regarding state income tax issues; Florida, drafting legislation for a sales tax on services and defending the constitutionality of the legislation in the Florida courts; Georgia, providing advice to the Georgia Department of Revenue on income, sales and use, and property tax issues; Louisiana, drafting legislation for a coastal wetlands environmental levy and defending the constitutionality of the legislation before legislative bodies; Montana, drafting substantial portions of the state's briefs in the state district court, the state supreme court, and the United States Supreme Court defending the constitutionality of Montana's coal severance tax in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981); North Dakota, providing expert assistance in a state income tax controversy; Texas, serving as a consultant to the Texas Select Committee on Tax Equity; and Virginia, defending the State Department of Revenue in an income tax refund suit. My consulting activities with private industry include advice and assistance on income, sales and use, property, and miscellaneous excise taxes, particularly with regard to federal constitutional issues raised by such levies, and I have participated on behalf of private industry in litigation before the United States Supreme Court in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978), *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266 (1987), *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1990), *Trinova Corp. v. Michigan Department of Treasury*, 498 U.S. 358 (1991), *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992), *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992), a case I argued; *Colgate Palmolive Co. v. Franchise Tax Board*, 512 U.S. 298 (1994), *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), and *Hunt-Wesson, Inc.*

v. Franchise Tax Board., 528 U.S. 458 (2000), a case I argued.

6. I have frequently been a faculty member at continuing education programs devoted to state and local taxation, as indicated on pages 2-4 of my resume (see Exhibit A).

7. In connection with the preparation of this affidavit, I have reviewed, among other things, (a) the complaint; (b) the memoranda of law filed in support of and opposition to the motion to dismiss; (c) the court's decision and order denying defendants' motion to dismiss; (d) the affidavits of Robert Eyler and Hans L. Stern; (e) plaintiffs' memorandum in support of their motion for summary judgment; and (f) various state statutes relating to taxation of alcoholic beverages.

The Historical Tradition of Imposing "Sin" Taxes on the Alcoholic Beverage Industry

8. There is a long history in state taxation of singling out alcoholic beverages and tobacco products for special excise taxes (apart from and in addition to the traditional retail sales tax) for the dual purposes of (1) raising revenue and (2) discouraging consumption of such products by increasing their cost to the consumer.

The Legal Framework Governing State Taxation of Interstate Sales

9. Under the U.S. Supreme Court's interpretation of the Commerce Clause of the Federal Constitution, the states lack the constitutional power to impose a sales tax on goods purchased in other states or in interstate

commerce because "to impose a tax on such a such transaction would be to project its powers beyond its boundaries and to tax an interstate transaction." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 328 (1944). The constitutional prohibition on the states' taxation of sales consummated outside their borders or in interstate commerce created a troublesome gap in their consumption tax structures. The gap created two concerns. First, states feared the loss of business that local merchants would suffer when prospective customers made out-of-state or interstate purchases to avoid in-state sales tax liability. Second, states feared the loss of revenue they would incur as a result of the diversion of sales tax to non-tax states. To deal with this potential loss of business and revenue, states enacted "complementary" or "compensating" use taxes on the use of goods purchased outside the state and brought into the state for use.

10. Compensating use taxes are functionally equivalent to sales taxes. They are typically levied upon the use, storage, or other consumption in the state of tangible personal property that has not been subjected to a sales tax. The use tax imposes an exaction equal in amount to the sales tax that would have been imposed on the sale of the property in question if the sale had occurred within the state's taxing jurisdiction. The state overcomes the constitutional hurdle of taxing an out-of-state or interstate sale by imposing the tax on a subject within its taxing power – the use, storage, or consumption of property within the state. See *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937) (sustaining constitutionality of state use tax scheme). In principle, then, the in-state purchaser stands to gain nothing by making an out-of-state or interstate purchase free of sales tax because he or she will

ultimately be saddled with an identical use tax when the property is brought into the taxing state. Taken together, sales and use taxes provide a uniform scheme of taxation on goods purchased within the state and goods purchased outside the state for "storage, use, or consumption" within the state. Every one of the 45 states (and the District of Columbia) that imposes a sales tax also imposes a compensating use tax.

11. State sales taxes generally are collected by the vendor from the purchaser, and all states have some system for registering vendors as collection agents. Once a vendor registers with the state, it is authorized to make sales at retail, and it is required to collect and remit taxes on taxable sales. Accordingly, when a registered vendor within the state delivers taxable goods to a purchaser within the state, it must collect the sales tax due, unless the purchaser presents it with a certificate establishing that the sale is exempt (e.g., a resale certificate) or that the purchaser has a "direct pay" permit allowing it to self-assess the tax and pay it directly to the taxing authority. A vendor is ordinarily liable (either primarily or secondarily) for tax on any taxable transaction, whether or not it collects it from the purchaser. There are no constitutional difficulties in requiring the registered vendor to collect the sale tax.

12. When interstate sales of taxable goods are involved, the use tax rather than the sales tax is applicable. As explained above, it is beyond dispute that the purchaser is legally liable for the tax on the use of the taxable goods or services within the taxing state. It is also settled law, as the U.S. Supreme Court declared in one of the seminal cases establishing the constitutionality of the use tax and the vendor's obligation to collect the tax, that

making "the distributor the tax collector for the State is a familiar and sanctioned device." *General Trading Co. v. State Tax Commission*, 322 U.S. 335, 338 (1944). In the use tax context, however, the implementation of this "familiar and sanctioned device" of making the vendor the collection agent for the state can encounter constitutional difficulties that do not arise in the sale tax context.

13. Because the use tax generally applies to transactions involving interstate sales, and the vendor often has little or no physical presence in the state, it raises the constitutional question whether the state has the jurisdictional power to require the vendor to register and collect the tax. The U.S. Supreme Court has declared that it is a "fundamental requirement of both the Due Process and Commerce Clauses that there be 'some definite link, some minimum connection between a state and the person, property, or transaction its seeks to tax.'" *Allied Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 777 (1992) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954)). This so-called "nexus" requirement derives from the virtually axiomatic proposition that the exercise of a state's tax power over a taxpayer or its activities is justified by the "protection, opportunities and benefits" (*Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)) the state confers upon the taxpayer or its activities. If the state lacks the "definite link" or "minimum connection" with the taxpayer or its activities, it has not "given anything for which it can ask return." *Id.* In the context of use taxes, the essential question becomes whether there is a sufficient connection with (and, hence, jurisdiction over) the out-of-state vendor to justify the state's enlisting the vendor to collect tax on its sales to in-state purchasers.

14. In *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), the U.S. Supreme Court first considered the question whether a state could require an out-of-state mail-order vendor with no physical presence in the state to collect a use tax on goods sold to in-state purchasers. In that case, Illinois sought to compel a Missouri mail-order seller to collect a use tax on goods sold to Illinois purchasers. National Bellas Hess challenged the tax under both the Due Process and Commerce Clauses of the Federal Constitution. After reiterating that there must be "some definite link, some minimum connection between a state and the person, property or transaction its seeks to tax," id. at 756 (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-345 (1954)), and that such a "link" or "connection" between the out-of-state vendor and the state was a prerequisite to imposing on a vendor the duty to collect use tax, the Court concluded that Illinois had exceeded the limits established by the Court's precedents. The Court stated it "has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail." *Id.* at 758. The Court focused specifically on the lack of harmonization in the states' retail sales tax regimes, which created intolerable burdens on distance sellers if they could be required to collect use taxes in all states and localities into which they shipped the goods they sold:

> The many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of local government."

Id. at 759-60 (footnotes omitted). Declaring that the "very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements," *id.* at 760, the Court held the assessment unconstitutional.

15. In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the Supreme Court reaffirmed the rule of *Bellas Hess* and held that the Commerce Clause bars a state from imposing a use tax collection duty on an out-of-state seller with no physical presence in the state. In so holding, however, the Court made it clear that the Due Process Clause was no bar to the imposition of a use tax collection obligation on an out-of-state seller with no physical presence in the state as long as the out-of-state seller was purposefully directing its efforts towards residents of the taxing state. Instead, the Court in *Quill* rested the physical presence-requirement entirely on the Commerce Clause.

16. In delineating the due process restraints on a state's power to require an out-of-state vendor to collect use taxes with respect to sales of mail-order goods to purchasers within the state, the Court in *Quill* observed that "[d]ue process centrally concerns the fundamental fairness of governmental activity," *id.* at 312, and it explained that "due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him." *Id.* The Court had held in the analogous area of judicial jurisdiction that "if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State." *Id.* at 307. Applying these standards to the imposition of a tax collection requirement

upon an out-of-state vendor, the Court declared that, so long as an out-of-state mail-order vendor purposefully directs its solicitation towards residents of the taxing State, "it matters little that such solicitation is accomplished by a deluge of catalogs rather than a phalanx of drummers: the requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State." *Id.* at 308.

17. Even assuming that a taxpayer has due process nexus with a state, however, the Court in *Quill* concluded that there are different nexus inquiries under the Due Process Clause and the Commerce Clause. Consequently, "a corporation may have 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 313. Specifically, because the principal concern of the Commerce Clause is national economic unity and "the effects of state regulation on the national economy," *id.* at 312, the Court in *Quill* found that these concerns gave rise to a nexus inquiry that focused on the burdens the tax collection obligation imposed on interstate commerce rather than on the fairness of imposing the obligation on the out-of-state vendor. After assessing those burdens in light of the unharmonized patchwork of sales taxes imposed by state and local taxing jurisdictions, the Court in *Quill* concluded that the physical-presence test of nexus it had articulated 25 years earlier in *Bellas Hess* remained the Commerce Clause "substantial nexus" standard governing state use tax collection obligations. The Court defended the "bright-line" physical-presence rule of nexus on the ground that it "firmly establishes the boundaries of legitimate state authority," "reduces litigation," "encourages settled

expectations," and, serves the "'interest in stability and orderly development of the law' that undergrids the doctrine of *stare decisis*. . . . " *Id.* at 315-17 (citations omitted).

The Impact of Existing Constitutional Restraints on State Taxing Power on the States' Ability to Collect Taxes from Remote Vendors

18. Under the legal framework described above, the states lack the constitutional power to require a vendor without physical presence in the state to collect taxes on products that the vendor ships to consumers in the state. Because it is not practical to collect such taxes from individual purchasers, the states lose billions of dollars of revenue each year from their inability to require out-of-state vendors to collect use taxes on products they sell to in-state consumers.

19. If this constitutional framework were applicable to the direct sale of wine from out-of-state vendors to in-state consumers, it is my opinion that the states would lose the practical ability to collect taxes on such products. The existence of legislation in Louisiana, New Hampshire, and Nevada referred to in the affidavit of Hans L. Stern that "includes provisions for wineries' payment of taxes to states in which consumers receive their product" (Stern Affidavit, ¶ 77) does not change my opinion. Indeed, the state statutes are filled with similar provisions mandating out-of-state vendors to collect taxes on their sales to in-state consumers.

20. For example, in Texas, as in many other states, there are provisions that assert broad authority to require any "retailer who sells a taxable item for storage, use, or

consumption in this state" to register with the taxing authority. Tex. Tax Code Ann. §§ 151.106 (West Supp. 2001). Furthermore, such statutes typically require a "retailer engaged in business in this state who makes a sale of a taxable item for storage, use, or consumption in this state" to "collect the use tax that is due from the purchaser." Id. § 151.103. The Texas statute, like those of many other states, considers a retailer to be "engaged in business in this state" if, among other things, it "engages in regular or systematic solicitation of sales of taxable items in this state by the distribution of catalogs, periodicals, advertising flyers, or other advertising, by means of print, radio, or television media, or by mail, telegraphy, telephone, computer data base, cable, optic, microwave, or other communication system for the purpose of effecting sales of taxable items." Id. § 151.107(a)(4). Yet these statutes are plainly unenforceable under the Court's existing Commerce Clause jurisprudence as applied to vendors without physical presence in the state.

21. Indeed, the State of New York, recognizing the Commerce Clause restraints on its power to require an out-of-state vendor to collect sales and use taxes, explicitly limits its definition of a vendor required to register and collect such taxes as one whose in-state activity "satisfies the nexus requirement of the United States constitution," see N.Y. Tax Law §§ 1101(b)(8)(i), 1131 et seq. (McKinney 2000, Supp. 2001), i.e., the physical presence requirement of *Quill*. See *Orvis v. Tax Appeals Tribunal* and *Vermont Information Processing, Inc. v. Tax Appeals Tribunal*, 86 N.Y.2d 165, 654 N.E.2d 954, 630 N.Y.S.2d 680, *cert. denied* (in *Vermont Information Processing*), 516 U.S. 989 (1995).

New York's Alcoholic Beverage Control Law Provides an Effective Mechanism for Collection of Taxes on Wine Sold by Out-of-State Vendors

22. As the foregoing discussion reveals, if the constitutional framework described above were applicable to the direct sale of wine from out-of-state vendors to in-state consumers, it would have a devastating impact on New York's ability to collect taxes on or with respect to such wine sales. By contrast, New York's existing regime governing the sale of wine in the state provides an extremely effective mechanism for tax collection as opposed to the ineffective alternative to which Mr. Stern's affidavit alludes. Because virtually all retail sales of wine to consumers in the state must be made by a licensed retailer, the state can enforce collection of the sales tax on such sales, just as it enforces its sales tax with respect to other licensed retailers. Moreover, by requiring that out-of-state vendors sell their wine through licensed wholesalers, the state can assure collection of the liquor excise tax that would otherwise escape taxation if out-of-state vendors could sell their products directly to in-state consumers.

Further affiant sayeth not.

/s/ Walter Hellerstein
WALTER HELLERSTEIN

Subscribed and sworn to before me
this 31st day of July 2001.

/s/ Clair R. Drew
Notary Public

My commission expires 9/2/2002.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Affidavit of Howard P. Kitt, sworn to on August 16, 2001, in Support of Defendants' Cross-Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment, dated August 17, 2001

AFFIDAVIT OF HOWARD P. KITT

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STATE OF NEW YORK)
) ss:
COUNTY OF WESTCHESTER)

HOWARD P. KITT, being duly sworn, deposes and says:

I. Introduction

1. I am an economist and Senior Vice President employed by National Economic Research Associates, Inc. ("NERA"), based in White Plains, New York. I have been designated by counsel for Defendants to provide expert testimony in this case. My resume has previously been submitted as an attachment to Defendants' designation of Howard P. Kitt to provide testimony. A copy is attached as Exhibit A.

II. Assignment

2. Counsel for Defendants have asked me to evaluate (1) the extent, if any, to which New York State law impedes out-of-state wineries' access to New York buyers; (2) the extent, if any, to which New York State law impedes

New York buyers' access to out-of-state wineries' wines; (3) the extent to which out-of-state wineries that wish to ship directly to New York State compete with New York wineries for the business of New York consumers; (4) whether New York State law protects New York wholesalers from competition; and (5) various issues raised by the affidavit of Dr. Robert Eyler.[1]

3. In carrying out this assignment, I reviewed a number of documents and pleadings produced by the parties as well as publicly available data and information. I, and/or members of my staff operating under my supervision and direction, also reviewed various deposition transcripts and spoke with a number of intervenor-defendants' personnel. A list of these items is attached to this affidavit. I also relied upon basic principles of modern microeconomic theory and my experience in analyzing issues of this type. My analysis is ongoing. Accordingly, I may extend and/or modify my analysis and conclusions as more information becomes available.

4. My principal conclusions can be summarized as follows:

i. Access to the New York State marketplace by wines produced out of state is effectively unimpeded.

ii. Access by New York State wine consumers to wines produced out of state is similarly unimpeded.

iii. In light of the economic realities of the New York State marketplace, New York State

[1] Affidavit of Robert Eyler, May 24, 2001 ("Eyler Affidavit").

wineries have little, if any, practical competitive advantage vis-a-vis out-of-state wineries.

iv. As a consequence of the above, the New York State wine market is openly, intensely and effectively competitive, and no producer or distributor is insulated from the forces of that competition.

5. My report is organized as follows: The next section (section III) sets out the main economic issues that I consider, and section IV presents evidence that addresses those issues. In Section V, I discuss economic incentives in the wine industry and their implications for some of the economic issues in question. Section VI discusses various aspects of Dr. Eyler's affidavit and deposition, and Section VII provides a brief conclusion.

III. The Economic Issues

6. As I understand it, Plaintiffs have alleged that New York law impedes the flow of wine from out of state. They may also allege that those who wish to sell wine in New York State that is produced outside New York are disadvantaged relative to those selling wine produced in New York. Whether New York law has any such effects is importantly a matter of factual investigation. Accordingly, from an economic perspective, the relevant question is: Does the three-tier structure or any distinctions between wine produced in New York and outside New York make any substantive economic difference? More specifically,

i. Does the existing legal structure in New York effectively restrict the sale in New York of wine that is produced out of state?

ii. Does the existing legal structure in New York effectively restrict New York consumers' ability to buy wine produced outside New York State?

iii. Does New York State law treat out-of-state wines and/or wineries in a way that protects in-state wineries from competition from out-of-state wineries?

iv. Does New York State law protect New York wholesalers from competition?[2]

7. No abstract or theoretical model can answer the questions posed above.[3] Only evidence on the actual performance of the industry can shed light on them. Unlike Plaintiffs' expert Dr. Eyler, therefore, I do not discuss below any idealized models. Instead, I turn now to a description of the New York marketplace for wine and the empirical evidence.

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[2] In addressing these issues, it is important to bear in mind that, as I understand it, the Twenty-first Amendment does give states the right to regulate the transportation and importation of wine.

[3] No such model provides an appropriate benchmark in this case. As the authors of one of the best-known textbooks explain in their discussion of the theoretical model of perfect competition, "The perfectly competitive world of the economist is like the frictionless model of the physicist. It is not a picture of the real world we meet when we step outside the library and rub elbows with people on the street." Paul Samuelson and William D. Nordhaus, with the assistance of Michael J. Mandel, *Economics*. 15th ed. (New York: McGraw-Hill, Inc., 1995), pp. 271-272.

IV. Evidence on the Availability of Wine in New York

8. If existing regulations on the distribution of wine effectively restrict out-of-state wineries' ability to sell wine in New York or New York consumers' ability to buy wine produced outside the state, at the outset, I would expect to find that only a small percentage of the total volume of wine sold in New York comes from out-of-state wineries. Moreover, I would not expect to find wine from many different out-of-state wineries available in New York State. In fact, as the evidence below shows, I find quite the opposite: A very substantial proportion of wine sold in New York comes from out of state (see discussion below), and that wine comes from numerous different wineries selling many different brands.

9. The available data demonstrate that out-of-state wine comes from many different sources. To get a sense of the locations of the sources of wine available to New York consumers, I tabulated data on the brands available through wholesalers whose price lists appeared in the April 2001 issue of the Metro New York edition of *Beverage Media*, a monthly trade publication. For wholesalers that choose to list their products in *Beverage Media*,[4] the publication includes price lists for the products that those wholesalers sell to retailers. For wines, *Beverage Media* includes two sources of information: a Brand Index, which lists wine brands by location of the winery, and a separate section that includes price lists for individual distributors ("wholesaler pages"). Although the information in the two sections overlaps, the wholesaler pages include a number

[4] Listings are voluntary.

of brands, often smaller labels, that do not appear in the Brand Index.[5]

10. Exhibit 1 provides summary information on the number of brands available. While *Beverage Media* lists 47 brands from New York wineries, it lists 49 brands from Oregon wineries, 39 brands from Washington State, and over 750 brands available from California wineries, the other main wine-producing states in the US.[6] In addition, the Brand Index alone lists more than 3,600 foreign brands.[7] For many brands, of course, the wineries offer several different types of wine. Needless to say, those numbers suggest that a very wide range of out-of-state wine is available in New York through the existing three-tier system.

11. Moreover, according to *Beverage Media's* Brand Index, the number of out-of-state brands available through New York wholesalers has increased substantially since 1991. Exhibit 2 provides data on the number of brands listed in *Beverage Media's* Brand Index in December 1991, December 1996, and April 2001. Note that the number of

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[5] I understand that the wholesaler pages themselves may not include a complete list of brands available from the distributors. In some cases, apparently, wineries explicitly request that wholesalers *not* list their brands in *Beverage Media*. They may do so in order to increase the cachet of their brands and/or because they produce only a limited volume of wine.

[6] The "Other U.S." wineries listed include Barboursville Vineyards, located in Virginia.

[7] Plaintiffs' expert Hans Stern was not surprised that so many imported brands are available, because "this is the strongest import market in the U.S." He also acknowledged that imported wine goes through the three-tier system. (Deposition of Hans L. Stern, August 2 and 3, 2001 ("Stern Deposition"), p. 62)

California brands increased nearly 50 percent between 1991 and 2001, the numbers of brands available from Oregon and Washington have each more than doubled, and the number of foreign brands has increased nearly 90 percent.

12. In principle, of course, it might be conceivable that those out-of-state brands come from a very limited number of wineries. To address that possibility, Exhibit 3 summarizes information on the number of wineries represented by the brand counts in Exhibit 1. Column (d) in Exhibit 3, which lists the total number of brands available from each indicated location, matches column (c) in Exhibit 1. Columns (a), (b), and (c) of Exhibit 3 provide a breakdown of the totals listed in column (d). For California, for example, Exhibit 3 indicates that the 765 brands came from at least 534 distinct wineries (column (a)). It also shows that 84 California brands (column (b)) listed in *Beverage Media* are "secondary" brands that were produced by the 534 distinct wineries that I identified. For the other 147 brands (column (c)), I was unable to determine whether they were made by one of the 534 wineries tallied in column (a) or by other wineries. The other rows in Exhibit 3 provide analogous data for the other locations. Exhibit 3 shows that wholesale distributors in metropolitan New York offered wines from at least 625 domestic wineries located outside New York – and possibly many more.

13. Note, moreover, that both large and small out-of-state wineries distribute their wine through wholesalers licensed in New York. Exhibit 4 provides estimates, where

available, of the levels of annual production for the out-of-state domestic wineries whose wines are listed in the April 2001 issue of *Beverage Media*.[8] While the list certainly includes the large, well-known wineries – *e.g.*, Sutter Home, Woodbridge, and Paul Masson, each of which produces millions of cases each year – it includes many small wineries as well. The exhibit includes, for example, over 200 wineries with annual production of 10,000 cases or less – and 87 wineries with annual production of 3,000 cases or less.[9]

14. Those numbers (200 and 87), moreover, undoubtedly understate the true number of small wineries represented by New York wholesalers: Note that Exhibit 4 includes several pages of wineries for which I was unable to obtain production estimates. Although some of those wineries may be large, many of them are likely to be quite small. (It is reasonable to assume that production estimates are less likely to be publicly available for small wineries.) Furthermore, *Beverage Media* does not include all licensed wholesalers – and even those wholesalers that are included in *Beverage Media* do not list all wines from all wineries whose wines they distribute. In short, the size distribution of the wineries in Exhibit 4 certainly belies

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[8] As indicated in the exhibit, sources of information for estimates of annual production included several websites, including winetoday.com; websites of the wineries themselves; James Laube, *Wine Spectator's California Wine*, second ed. (New York: Wine Spectator Press, 1999); Stephen Brook, *The Wines of California* (London, New York: Faber and Faber, 1999); and phone calls to individual wineries.

[9] Swedenburg Winery produces "approximately 1,500-2,000 cases" per year. (Affidavit of Juanita Swedenburg, May 22, 2001, ¶ 5) *The Wines of California* estimates Lucas Winery's production at 2,000 cases. (Stephen Brook, *The Wines of California* (London, New York: Faber and Faber, 1999), p. 606)

any claim that New York wholesalers distribute only large wineries' products.[10]

15. It is also interesting to compare the size distribution of wineries in Exhibit 4 to the table entitled "Analysis of California Wine Shipments [in 1996], Arrayed by Winery Size Class," attached to the Matanzas Creek Winery's Statement for the Joint Hearing of the Senate Select Committee on California's Wine Industry and the Assembly Select Committee on California Wine.[11] According to that table, submitted by Plaintiffs, large and medium wineries in California, defined as those that shipped over 100,000 cases in 1996, *were* "adequately served by the three-tier system." Note, incidentally, that those wineries accounted for nearly 96 percent of total California winery shipments.[12] Matanzas Creek's written statement adds that wineries that shipped 50,000-100,000 cases in 1996,

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[10] That, of course, is hardly surprising: The sale of wine is importantly demand – rather than supply-induced; *i.e.*, what matters primarily is not the amount produced but rather the adequacy of demand.

[11] See the Joint Hearing on "The Future of Direct Shipments of Wine," St. Helena, California, November 10, 1997, appended to the Affidavit of Clint Bolick, Volume II of Plaintiff's Notice of Motion and Motion for Summary Judgment.

[12] According to the Winery's written statement, "The fact is 95% of California wine (11,876,000 cases), produced by about 45 wineries is unquestionably shipped to market through the three-tier wholesale system!" That statement reflects an error in reading the table attached to the Winery's statement: The 11,876,000 cases mentioned were the shipments of 43 "medium" wineries that each shipped 100,000 to 1,000,000 cases. It excludes 149,137,000 cases shipped by 15 large wineries that each shipped over 1,000,000 cases. The Winery's written statement about wineries whose wine was unquestionably shipped through the three-tier system, therefore, should refer to nearly 96 percent of California wine (161,013,000 = 149,137,000 + 11,876,000 cases), produced by 58 wineries.

which accounted for another 1.1% of California shipments, were also "arguably" served by the three-tier system. While Matanzas Creek's statement suggests that wineries that shipped less than 50,000 cases were *not* adequately served by the three-tier system, Exhibit 4 shows otherwise: In New York, licensed wholesalers listed in *Beverage Media* carry wines from more than 350 wineries with annual production of less than 50,000 cases – many of which are located in California. Furthermore, many, if not most, of the wineries for which Exhibit 4 lists no production estimate probably also produce less than 50,000 cases per year. In New York, therefore, the three-tier system apparently serves even small wineries quite well.

16. The available evidence also suggests that New York consumers do not suffer from any dearth of out-of-state sources for the major types of wine produced by the plaintiff wineries, Lucas Winery and Swedenburg Winery. Exhibit 5 presents data on the number of wines of six different types produced by those wineries – cabernet sauvignon, pinot noir, zinfandel, chardonnay, riesling, and white zinfandel – that New York consumers could order from eVineyard.com on July 6, 2001.[13] Note that the numbers in Exhibit 5 reflect the number of wines available on one day from only one particular website. They do not include the wines available from the many other websites

[13] eVineyard.com, like other websites that sell wine, requires that the user indicate the state to which the wine will be shipped. As indicated in the attached tables, Exhibits 5-7 include in their tallies of chardonnays, pinot noirs, cabernet sauvignons, and white zinfandels various alternative designations for those types. See Exhibits 5-7 for details.

that sell to consumers – let alone the numerous brick-and-mortar retailers in New York.

17. Nonetheless, it is clear from Exhibit 5 that New York consumers have a considerable number of choices for each of these types of wine from wineries outside New York. The exhibit shows, for example, that New York consumers can choose from more than 150 zinfandels, more than 200 pinot noirs, and over 350 cabernet sauvignons. As the notes to the table indicate, wines of the same brand but different vintage are *not* counted as separate choices. Had they been counted separately, of course, the numbers in Exhibit 5 would be even higher. Note, moreover, that consumers' choices include a wide range of prices for five of the six types; the one exception, of course, is white zinfandel, an inherently inexpensive wine. (Even for white zinfandels, consumers can choose among 17 out-of-state wines.)

18. Exhibits 6 and 7 provide another perspective on the availability of the six main wine types considered in Exhibit 5. For each of those wine types, Exhibit 6 shows the number of wines available through Peerless and Charmer, according to *Beverage Media*; Exhibit 7, the number of wines available through New York wholesalers that are *not* listed in *Beverage Media*. Exhibit 7 relies on the March 2001 price postings that wholesalers file with the state. Both exhibits convey the same message: New York wholesalers offer a plethora of choices for each of the six wine types.

19. To summarize, the data in Exhibits 1-6 provide considerable evidence that the three-tier distribution system and New York's ban on direct shipments from out-of-state wineries have had little effect, if any, on (1) out-of-state

wineries' ability to sell wine in New York or (2) New York consumers' ability to buy wine from out-of-state wineries.[14]

20. The large number of wineries of all sizes that sell wine through wholesalers in New York belie any claim that the existing legal structure imposes effective obstacles to the sale of wine by out-of-state wineries. In retrospect, of course, that is hardly surprising: After all, New York law does not prohibit wine sales by out-of-state wineries; it simply prohibits one particular channel of distribution by such wineries – a channel that may not, in fact, be particularly efficient for most of those wineries. (I return to this point below.)

21. Out-of-state wineries can and do sell to New York retailers through wholesale distributors, as do many New York wineries as well.[15] Moreover, there are no

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[14] Plaintiff's expert John Dyson apparently agrees. "We [New York wineries] have nothing to fear from greater ease of entry into the New York market. Abundant competition already exists." (Affidavit of John Dyson, May 24, 2001 ("Dyson Affidavit"),¶ 27) Plaintiffs' expert Hans Stern also addressed the likely effects of allowing direct shipping:

> Q: And it's unlikely, as a matter of fact, it's virtually impossible to conceive that the flow of goods will be any different in that . . . there will be less New York wines sold in New York than there already is?
>
> . . .
>
> A: Probably true. Again, no absolutes.
>
> (Stern Deposition, pp. 206-207)

[15] At least 28 wineries produced the 45 New York brands listed in the Brand Index of the April 2001 issue of *Beverage Media*. (I was unable to determine which wineries produced 17 of the New York brands that are listed.) At his deposition, Plaintiffs' expert John Dyson agreed that "probably" half of the wineries in New York State use wholesale distributors to distribute their wine in New York State. (Deposition of John Dyson, August 1, 2001 ("Dyson Deposition"), p. 27) About a month ago, Mr. Dyson's Millbrook (NY) Winery entered into an

(Continued on following page)

effective obstacles to entry into wholesale distribution. A one-year wholesale wine license costs $1,075, with a surety bond of $10,000, and the wholesaler must satisfy a few other basic requirements.[16] In fact, Plaintiffs' expert John Dyson, who owns a majority interest in an Italian winery, also owns a majority interest in Pebble Ridge Vineyard, a licensed New York wholesaler that distributes his Italian wine.[17] At his deposition, Mr. Dyson testified that it cost "probable [sic] a few to maybe $10,000, counting the legal fees," to obtain the wholesale license, and only a few hundred dollars per year to renew the license.[18]

22. I am advised that nothing prevents an out-of-state winery from obtaining such a license.[19] Indeed, if a

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agreement with Colony, a New York wholesaler, to distribute their wines in all parts of New York State outside New York City, Long Island, and Westchester and Dutchess Counties. (Dyson Deposition, pp. 27-33)

[16] A wholesale licensee must, for example, have an office in New York State with an employee present during regular business hours, and must keep books and records on the licensed premises available for inspection during regular business hours. See http://www.abc.state.ny.us/faq.html for further details.

[17] Dyson Deposition, pp. 75-76.

[18] Dyson Deposition, pp. 76-77. Mr. Dyson also owns majority interests in wineries in New York (Millbrook Winery) and California (Williams and Selyem). Mr. Dyson described yet another way that wine produced outside New York State is distributed in New York: "Millbrook asked Williams and Selyem under a contractual arrangement to make wine to its standards and that wine is then shipped winery to winery and then distributed by Millbrook winery in the State of New York." (Dyson Deposition, p. 71)

[19] Plaintiff's expert John Dyson said he was not aware of anything that restricts an out-of-state winery from obtaining a wholesale wine license in New York. (Dyson Deposition, pp. 90 and 95) Plaintiff's expert Hans Stern, when asked to assume that an out-of-state winery could obtain a wholesale wine license in New York, said, "I think it's a

(Continued on following page)

winery or wineries believe they can sell any appreciable amount of wine in New York State *and* believe they can distribute it at substantially lower cost than existing wholesalers, the requirements to become a wholesale distributor are not so burdensome that they constitute an economic impediment.[20]

23. Of course, with over 200 wholesale licensees in New York State already, there is every reason to believe that competition helps keep distribution costs near their minimum[21] – and not only for larger brands. Indeed, the testimony of Plaintiffs' expert Hans Stern casts doubt on claims that smaller brands in particular lack wholesale distribution in New York: In discussing why he expects the wholesale market for wine to be more fragmented than the wholesale market for spirits, he explained: "Because the need to serve Metro New York, which is a heavy wine consuming market and *it's a lot of little guys with some*

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premise that's invalid." To the extent that his opinion is premised on an out-of-state winery's inability to obtain such a license, if that premise were wrong, he would "want to rethink" his opinion. (Stern Deposition, pp. 223-225) I understand that out-of-state wineries may also obtain a New York winery license as long as they maintain an office in New York and establish a "storage or warehouse" facility in the state to house their product for distribution here. For purposes of my opinion, however, I have not relied on any such ability. If out-of-state wineries can indeed get a New York winery license, that simply lends further support to the opinion I have already formulated: that New York affords out-of-state wineries ample opportunity to distribute their product and presents no barrier to entry here.

[20] As I understand it, for example, nothing prevents Lucas Winery, on its own or together with other wineries in the Lodi region, from obtaining a wholesale license in New York.

[21] See section VI.B.1 below for further discussion of the number of New York wholesalers.

smaller brands that do a pretty good job in New York in certain keys accounts, important accounts."[22]

24. As the exhibits discussed above also demonstrate, the three-tier structure and the ban on direct shipments from out of state do not constrain New York consumers' choices. With consumers enjoying the opportunity to choose wines from hundreds of out-of-state wineries, including numerous wines at virtually every price point for every major type of wine offered by the plaintiff

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[22] Stern Deposition, p. 105, emphasis added. In other testimony, Mr. Stern suggested that small producers might deliberately seek out small wine distributors:

> A: If I can only produce 5,000 cases, whatever the number, I want to be doggone sure that it doesn't go to some liquor store in Long Island. I want to focus my super premium $125 bottle of wine in restaurants and wine shops that cater to people who can afford $125 wine.
>
> . . .
>
> Q: It would be more likely that you would choose one of the boutique wine [distributors] –
>
> A: I probably would for this itty bitty winery, yes.
>
> . . .
>
> Q: The smaller wineries would tend to pick the boutiques if they have the quality wines?
>
> A: If they're paying at that price point, yeah.
>
> Q: The larger wineries would tend to sell through the larger wholesaler?
>
> A: Yeah.
>
> (Stern Deposition, pp. 115-116)

Later in his deposition, Mr. Stern returned to that point:

> Q: For the premium winery he wouldn't be looking for full market coverage, he's looking for the specialist, if he's a small winery, isn't that right?
>
> A: If he's smart, yeah.
>
> (Stern Deposition, p. 121)

wineries – as well as other types of wines, both domestic and foreign – it is clear that the existing legal restrictions cannot and do not act to reduce consumers' welfare to any noticeable degree.

25. Moreover, the evidence demonstrates clearly that New York's legal structure not distinguish out-of-state wineries in a way that protects in-state wineries from competition they might otherwise face. With hundreds of out-of-state wineries, including many small ones, selling wines in New York at all price points, the State's regulations obviously erect no obstacles to competition by out-of-state wineries with New York wineries.

26. Indeed, most of the wines produced by in-state wineries do not compete with those of out-of-state wineries that would like to ship directly to New York State consumers. Note, for example, that only a relatively small proportion of wine produced in New York is actually consumed in New York. In 1997, for example, New York wineries exported 86 percent of the 31,733,000 gallons (13,347,000 nine-liter case equivalents) of wine they produced to foreign countries or other states; only 14 percent (1,869,000 nine-liter case equivalents) was sold in New York.[23] That year, according to MKF WineStats, total wine consumption in New York was 17,447,000 nine-liter case equivalents.[24] In 1997, therefore, sales of wine produced by New York

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[23] *1998 Survey of New York Wineries*, New York Agricultural Statistics Service, available at www.nass.usda.gov/ny/bulletin/Winery/winery.htm, tables entitled "Wine Production and Capacity, By Wine Trail" and "Percent of Wine Sales by Location, Wine Trail, & Year."

[24] "1998 U.S. Wine Report," MKF WineStats (St. Helena, California: Motto Kryla & Fisher LLP, 1999). Section 3-33.

wineries amounted to less than 11 percent of New York wine consumption.[25]

27. Furthermore, table wine, which the plaintiff wineries produce,[26] accounted for only 35 percent of the total gallonage of wine produced by New York wineries in 1997. Fortified wine accounted for more than half of New York wineries' production, with sparkling wines, specialty wines, and dessert wines (none of which competes with Plaintiff wineries' wines) accounting for the rest.[27] Therefore, even

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[25] Data provided by Plaintiffs' expert Robert Eyler suggest that the percentage may be even lower than 11 percent. According to Dr. Eyler, New York State produces roughly 4% of total US production. (Eyler Affidavit,¶ 7, and Deposition of Robert Eyler, June 14 and 15, 2001 ("Eyler Deposition"), p. 227). If New York exports 86 percent of its production to foreign countries or other states, only 14% of New York's production – *i.e.*, 0.56% = 14% of 4% of total US production – remains in New York. Dr. Eyler also reports that New York consumption was 8.3% of US consumption in 1998. (Eyler Affidavit,¶ 7) If total US production is roughly equal to total US consumption, therefore, New York's production of wine accounts for roughly 6.7% (0.56%/8.3%) of New York's wine consumption. (In 1997, US wine production (533 million gallons) was a bit higher than US wine consumption (520 million gallons); in 1998, US wine production (494 million gallons) was a bit lower than US wine consumption (526 million gallons). Source: www.wineinstitute.org, citing Wine Institute/US WineStats from BATF data and Wine Institute/Gomberg, Fredrikson & Associates)

[26] Documents produced by Lucas Winery include small sales of "L.H." and "V.G." wine, in addition to zinfandel and chardonnay, which account for the bulk of his sales. I have not found definitions of either abbreviation in the documents produced by Lucas Winery.

[27] *1998 Survey of New York Wineries, op. cit.*, table entitled "Wine Production, by Year and Type." More recently, New York producers have contributed to the growth of another category of wine that does not overlap with the type produced by the plaintiff wineries: "Another growth area in 1999 was sweet, low-alcohol 'flavored wine.' Total shipments reached an estimated 6 million cases in 1999, with approximately 60 percent of this total produced in New York State. Most of this growth occurred under Canandaigua's Arbor Mist brand in 1998-99."

(Continued on following page)

the 11 percent and 6.7 percent figures overstate the percentage of New York State wine consumption in 1997 accounted for by table wine produced in New York.

28. Note also that most New York wineries apparently ship only small proportions of their wine directly to New York consumers. A 1998 survey of New York wineries' sales in 1997 asked wineries to divide their sales into four types: (i) direct to consumers at the winery; (ii) direct to restaurants and liquor stores; (iii) through a New York distributor; and (iv) Other, which includes both shipments to out-of-state customers and direct shipments to New York consumers.[28] In all but one of the New York producing regions considered, the first three types of sales accounted for at least 96 percent of sales by volume and at least 98 percent of sales dollars. As might be expected, a substantial fraction of sales by wineries in those regions were made at the wineries themselves – sales that would not compete directly with direct shipments to consumers by out-of-state wineries.[29]

("U.S. Wine Demographics Report," St. Helena, California: Motto Kryla & Fisher LLP, 2000, p. 13)

[28] Survey questionnaire, Section 5, for *1998 Survey of New York Wineries*, New York Agricultural Statistics Service. The table summarizing responses to that question, "Percent of Total Wine Sales and Dollars by Type of Sale by Region, 1997," lists the first type of sale as "Direct to Consumer." (*1998 Survey of New York Wineries*, New York Agricultural Statistics Service, available at www.nass.usda.gov/nyl bulletin/Winery/winery.htm) It is clear from the survey questionnaire itself, however, that that type includes only direct sales to consumers *at the winery*. (See question 4 in Section 5 of the survey questionnaire.) I have also verified that, as well as the other definitions, with State Statistician Stephen Ropel.

[29] In one BATF region, the "Finger Lakes" region, 87% of sales by volume and 83% of dollar sales were classified as "Other," the category

(Continued on following page)

29. Finally, there is no sense in which the three-tier system protects New York wholesalers from competition. There simply is no basis, for example, for Plaintiffs' expert Robert Eyler's reference to "the distributor's monopolistic filter."[30] Without barriers to entry into wholesale distribution – and with numerous wholesale distributors competing with each other – the term "monopoly" is a misnomer. The state's regulations regarding wine distribution certainly do not protect distributors from competition.

V. Economic Incentives in the Wine Industry

In this section, I briefly discuss some of the economic incentives of the various participants in the wine industry. Those incentives help shed light on why the industry's participants do business as they do, why New York's

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that includes sales to out-of-state customers and direct shipments to New York consumers. It is clear, however, from other reported survey results, that sales to out-of-state customers – not direct shipments to New York consumers – accounted for the bulk of those sales. Based on data reported for the state as a whole, the "Finger Lakes" BATF region accounted for the bulk of total state sales. Another table in the survey reports "Percent of Wine Sales by Location, Wine Trail, & Year" for the following wine trails: Long Island, Shawangunk, Dutchess, Cayuga, Seneca Lake, Keuka Lake, and None; *i.e.*, it reports data by wine trail rather than by BATF region. That table groups sales by three locations: New York, Other States, and Other Countries. In that table, wineries in the "None" category (not on one of the listed wine trails) accounted for the bulk of total state sales. (See the table entitled "Wine Production and Capacity, by Wine Trail, which shows that wineries in that group produced 30,426,000 gallons, representing nearly 96% of the state's total production.) Thus there is considerable overlap between the "Finger Lakes" BATF region and the wineries that were not located on any of the listed wine trails. According to the survey, wineries that were not on any of the listed wine trails sold only 11% of their wine in New York; the other 89% was sold in other states or countries.

[30] Eyler Affidavit, ¶ 15.

regulations do not effectively restrict either New York wine consumers or out-of-state wineries, and why the ban on out-of-state direct shipments helps serve the legitimate interests of the state.

A. The Incentives to Sell Wine Through Wholesale Distributors

31. Wholesale wine distributors perform many useful functions for wineries and retailers. Among other services, wholesalers pay the freight charge for delivery of the wine to the wholesalers' local warehouses, where wine can be stored for next-day or same-day delivery to retailers; maintain contacts and create personal relationships with retailers that help promote sales; create signs and displays for retailers; coordinate wine tastings and other promotional events; and collect payments from retailers, taking the credit risk on bad retailer debt. (As I understand it, wholesalers pay wineries for the wine; they do not take the wine on consignment. As a consequence, wineries get their money upfront, before the actual sale to retailers.)

32. In addition, wholesalers pick, pack, and load goods for delivery from their warehouses to retailers; deliver wine to retailers from their warehouses; and often allow retailers to buy split cases so that they can order small quantities of wine. I also understand that wholesalers handle collection of New York's excise tax on wine gallonage, providing a service to both the state and wineries. Wholesalers also help the state monitor the flow and distribution of alcohol within the state, make sure that

wines are properly labeled, and ensure that they deliver wines only to retailers with current and valid licenses.[31]

33. In light of the many services wholesalers provide, it is reasonable to assume that many wineries – both in- and out-of-state – have an incentive to distribute wine through New York wholesalers.[32] As the exhibits mentioned above demonstrate, wineries of all sizes do in fact distribute wine successfully in New York this way.

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[31] Declaration of James Chatfield, August 15, 2001. See also Plaintiff's expert John Dyson's descriptions of services provided by wholesalers with which his wineries have contractual relationships: "They go with a representative of the winery to call on restaurants and retail stores in their respective jurisdictions. In a modest degree they do it on their own, without somebody from the winery having to be there. They take the order, they deliver the wine to the purchaser, and they bill the purchaser. They also store a modest quantity of wine within their state,. . . ." The wholesalers also ensure that excise taxes are paid to the states that require them and bear the costs of storage in their warehouses and local distribution within their jurisdictions. (Dyson Deposition, pp. 128-131)

[32] At his deposition, plaintiffs' expert Hans Stern also identified a fourth tier, marketers, in which he included Brown-Forman, for which he had previously worked. (Stern Deposition, p. 86) Marketers help wineries market and distribute their wine. Discussing the role of Brown-Forman, Mr. Stern said: "Not sure of the definition of middle man, but we took title to the product. Value we added was our salts and distribution and our marketing clout and the back room." Asked to explain "back room," he added: "Bill and pay. Getting legal clearance. We kept small inventory in the field, inventory product. Some we shipped directly from producer to wholesaler. But some, for smaller markets, we inventoried ourselves in ware-houses." (Stern Deposition, pp. 22-23) See also Stern Deposition, pp. 83-84, for Mr. Stern's discussion of the mutual benefits that a winery and marketer enjoy, and pp. 95-96 for his further discussion of the value added by a marketer in helping a winery market a brand.

B. Wholesalers' Incentives to Distribute Wines

As specialists in the logistics of wine distribution, wholesale distributors have considerable expertise in the transportation, marketing, and distribution of wine. Having expended the fixed costs of establishing their distribution network, wholesalers have considerable incentives to maximize the use of their network by maximizing the amount of wine distributed, regardless of the identity, size, or location of the winery. Thus it is hardly surprising to find that wholesalers carry wines from wineries from a variety of locations, many with very small levels of production (see, *e.g.*, Exhibit 4). I understand from personnel at Peerless, for example, that there is no minimum winery size below which they will refuse to carry the winery's products. As long as there is reason to believe that there is adequate demand for a wine from ultimate consumers, Peerless and other distributors have strong incentives to spread their fixed costs by carrying the wine.

35. To be sure, wineries, however large or small they may be, must give wholesalers reason to believe that there *is* a demand for their wine. Indeed, Plaintiffs' expert Robert Eyler himself suggested at his deposition that "if you are trying to compete, the perceived quality of the wine is key."[33] Elsewhere he states,

> How important are these reviews to the consumer? For California wineries, it [sic] seems to be the key for demand. Small quantities can be sold out in one day based on a single review. . . . These tasting scores act as barriers to

[33] Eyler Deposition, pp. 101-102.

> competition, and these barriers are key assets of US wineries.
>
> . . .
>
> The perceived quality of wine is, from an economic standpoint, the market fulcrum: A wine's tasting scores in key US publications determine, in many cases, the viability of the vintage and (in extreme cases) the brand. . . . a lack of quality is directly related to a lack of sales.
>
> . . .
>
> One of the most unfortunate, and most intriguing, aspects of the US wine industry is its dependence on tasting scores for demand. Like no other industry, quality seems to drive demand.[34]

At his deposition, Dr. Eyler elaborated on this theme:

> If I was running a business and I got a 92 in the Wine Spectator, I would slap it all over to make sure every consumer could see it.[35]
>
> At wineries I've worked at, for example, if the Wine Spectator comes out with a 90 or above score, they could in fact sell the entire lot of that winery out within a few days.[36]

36. Other Plaintiffs' experts apparently agree. Mr. Dyson, who owns majority interests in three different wineries, agreed that it is important to get good ratings in

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[34] Robert C. Eyler, "The International Competitiveness of the California Wine Industry," available at http://libweb.sonoa.edu/regional/faculty/eyler/eyler.html.

[35] Eyler Deposition, p. 108.

[36] Eyler Deposition, p. 110.

tests like those in *Wine Spectator* because "[i]t stimulates interest on the part of . . . the customer, to actually buy the wine from either us or somebody, down the chain, who then buys eventually from us."[37] Similarly, Mr. Stern testified that "[g]ood tasting scores will sell the product" while poor tasting scores will make it "very difficult" to sell, that "[t]here is a strong correlation" between tasting scores and quality, and that it "would make life damn hard" to try to sell wine as a premium product if it had a low tasting score.[38] Asked what a good tasting score is, Mr. Stern said he would be "happy [with] anything above 90."[39] Mr. Stern also indicated that highly rated wines, including ones produced by small wineries, do not have difficulty getting access to distribution by New York wholesalers:

> Q: Now, you don't know of any wine, however, that's ever received a 93 that hasn't been able to find access to the market through the wholesale system in New York?
>
> A: That's true.
>
> Q: In fact, for the small winery, there are wholesalers that are particularly well-suited to do that, these boutique wholesalers you mentioned?
>
> . . .
>
> A: Yeah.
>
> Q: In fact, that's what they specialize in?
>
> A: Uh-hum.[40]

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[37] Dyson Deposition, pp. 185-186.

[38] Stern Deposition, pp. 126-128.

[39] Stern Deposition, p. 126.

[40] Stern Deposition, pp. 160-161.

37. In short, a winery that successfully distinguishes its product and earns high tasting scores in major wine publications will give wholesalers every incentive to carry its products; high tasting scores can facilitate entry.[41] Plaintiff's expert Hans Stern addressed this issue at his deposition:

> Q: If you were representing a small winery and wanted to develop a reputation for quality is one of the things you would do is subject that wine to a tasting test?
>
> A: If I was damn sure that I had the best wine I could possibly make, yes.[42]

A winery that fails to earn high tasting scores and make sufficient efforts to distinguish its product may effectively erect barriers to its own entry or expansion.

38. Indeed, the plaintiff wineries may suffer from precisely such problems, rather than any "discrimination" allegedly created by New York's ban on direct shipments. In a response to a request for information from counsel for Peerless, for example, Clint Bolick, Vice President and Director of Litigation for the Institute of Justice, replies:

> The Lucas Winery has not received any awards or ratings. (Mr. Lucas questions the value and

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[41] Note, incidentally, that Dr. Eyler's comments may also explain why there aren't even more out-of-state wineries distributing wine through New York wholesalers: Demand may be so strong, in part because of their successful attempts to differentiate their wines and earn high tasting scores or awards, that they have no need or desire to sell to New York consumers; they can sell out quickly in their own state or locality.

[42] Stern Deposition, p. 221.

objectivity of these sorts of measures and does not enter his wines in competitions.)[43]

There are, in fact; numerous other sources of zinfandel that *have* been recognized. A compilation of the "Best U.S. Zinfandel Producers" by the Beverage Testing Institute for example, listed more than 100 producers; the Lucas Winery does not appear on the list.[44,45] Similarly, in two years worth

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[43] Clint Bolick, Vice President and Director of Litigation for the Institute for Justice, Response to Request 2, letter to Randy Mastro, Esq., April 26, 2001. Note also the review on winetoday.com of Lucas winery's 1998 Chardonnay, which described its aromas as "dried fruit, toast" and listed "bitter, hot impression from alcohol, ripe, slightly bitter, ultra-ripe" under Other Descriptors. (www.winetoday.com/reviews/index.html) In fact, Mr. Lucas also seems to have made a deliberate *choice* not to use a wholesaler and not to expend substantial resources in marketing his products: "The Lucas Winery does not have a New York wholesaler because it is costly and time consuming both to the wholesaler and to myself. I am not large enough to warrant the attention that a large winery receives from a wholesaler, cannot support the advertising, a winery representative, or the expense to personally visit the New York marketplace. *This is a choice I have made* as part of my business strategy in identifying my niche or place in the marketing of my wines." (Affidavit of David Lucas, ¶ 5. emphasis added) According to a 1996 article, "He [Lucas] admits that acceptance of his wines is more important to him than profits." (Bill Cook, "A Vintner's Avocation: One-Man Winery is One of Few in County," *The [Stockton, CA] Record*, August 19, 1996, p. D1.) Indeed, "[h]is day job involves working for the grower relations department of Mondavi Woodbridge." (Stephen Brook, *The Wines of California* (London, New York: Faber and Faber, 1999), p. 606)

[44] The list divides the producers into three categories: (i) 15 "Premier U.S. Zinfandel Producers," (ii) 38 "Great U.S. Zinfandel Producers," and (iii) 51 "Dependable U.S. Zinfandel Producers." (*The Beverage Testing Institute's Buying Guide to Wines of North America*, edited by Charles Laverick (New York: Sterling Publishing Co., Inc., 1999))

[45] Note also that grapes from the Lodi region, in which Lucas Winery is located, typically fetch relatively low prices compared to grapes from other regions in California, as Exhibit 8 shows.

of reviews downloaded from Winespectator.com in April, 2001, none of Swedenburg Winery's wines even appear, let alone earn a high rating.[46]

C. The State's Incentives to Ban Direct Shipments from Out-of-State Wineries

39. When confronted by regulations (regarding tax payments, sales to minors, or any other legitimate concerns of a state), wineries, like all other firms, are likely to consider their incentives to comply. Those incentives depend on, among other things, the costs and benefits of compliance, the probability of being caught if they do not comply, and the likely cost of non-compliance if they are caught. Since compliance imposes costs on wineries, other things equal they have an incentive to minimize those

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[46] While Swedenburg claims to " . . . have received over 200 awards at international wine competitions . . ."(Clint Bolick, Vice President and Director of Litigation for the Institute of Justice, Response to Request 2, letter to Randy Mastro, Esq., April 26, 2001), the nature and level of those awards and competitions are not specified, nor are the other wines that were entered. Indeed, if the reference to an award from the "Beverage Tasting-Institute" actually refers to the Beverage Testing Institute, note that the Beverage Testing institutes *Buying Guide to Wines of North America* rates one wine produced by Swedenburg Winery: its rating of Swedenburg's 1995 Cabernet Sauvignon is 80. The *Buying Guide's* rating scale includes *Superlative* (96-100), *Exceptional* (90-95), *Highly Recommended* (85-89), *Recommended* (80-84), and *Not Recommended* (under 80). (*The Beverage Testing Institute's Buying Guide to Wines of North America*, edited by Charles Laverick (New York; Sterling Publishing Co., Inc., 1999), pp. 13 and 304.) In addition, the web site of the *Journal of the Beverage Testing Institute* lists a Swedenburg 1999 Great Falls Vineyard, Vidal with a rating of 83. (www.tastings.com/search_wine.lasso)

costs by complying only to the extent they believe is necessary.[47]

40. Needless to say, not all wineries comply voluntarily. Consider, for example. Mr. Lucas' description of his operations when he began making wine:

> I made about 600 gallons of zinfandel a year. I would sell it to my friends for $1 a bottle or trade it for some figs. One day, a gray car pulled up and a gray man with a gray suit and a gray attitude got out. He was from the Bureau of Alcohol, Tobacco and Firearms.
>
> You can only bottle 200 gallons of wine for your own use without becoming a bona fide winery, so I became official on that day.[48]

41. Similarly, the following exchange from the deposition of Plaintiffs' expert John Dyson casts doubt on the notion that wineries will comply either readily or voluntarily with state laws:

> Q: Before the sting operation that you described that State Attorneys' [sic] General office, including New York's, conducted in the late '90s, did Millbrook ever ship directly to

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[47] Plaintiffs' expert John Dyson states, "If other out-of-state wineries were allowed to ship to New York, they easily *could* abide [by] the same requirements that New York wineries must follow in shipping directly to retailers and other consumers within New York." (Dyson Affidavit, ¶ 26, emphasis added) The relevant question is not whether they *could* do so, but whether they *would* do so, especially in light of New York's costs of monitoring, policing, and enforcing compliance of thousands of out-of-state wineries, as well as the probability of detection.

[48] Bill Cook, "A Vintner's Avocation: One-Man Winery is One of Few in County," *The [Stockton. CA] Record*, August 19, 1996, p. D1.

consumers in other states even though that violated those state's [sic] laws?

A: We shipped to other states because it was permitted by New York State law. *We didn't really investigate what the other states were involved with.*

. . .

Q: And you made direct shipments to some such states even though they had requirements of distribution through licensed wholesalers in the states; correct?

A: *We didn't investigate what their particular laws were one way or the other* and none of them has ever sanction[ed] us, as I have already testified.[49]

42. All else equal, an out-of-state winery that fails to comply with regulations is less likely to be detected than an in-state winery.[50] Similarly, since the state's difficulty and costs of enforcing compliance are likely to be higher for an out-of-state winery, an out-of-state winery's likely

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[49] Dyson Deposition, pp. 125-126 (emphasis added).

[50] As noted in the text above, Plaintiffs' expert John Dyson testified at his deposition that his Millbrook Winery made direct shipments to other states without investigating their particular laws "one way or the other." That discussion also provides insight on states' ability to detect violations of their laws:

Q: Were there any complaints of you?

A: No.

Q: How would they [other states] have even known that you were direct shipping?

A: I couldn't tell you, Counselor.

(Dyson Deposition, p. 126)

cost, even if caught, is lower than the likely cost for an in-state winery. For both reasons, an out-of-state winery has less incentive to comply with New York State regulations than does an in-state winery.[51]

43. The state, therefore, has understandable incentives to impose different regulations on in-state and out-of-state wineries.[52] In this industry, with literally thousands of out-of-state wineries and fewer than 200 wineries in New York, the state's incentives to impose tighter regulation on out-of-state wineries are that much greater. Given the wineries' and the state's incentives, therefore, it is neither surprising nor unreasonable that New York State requires out-of-state wineries to distribute. their wines through licensed New York wholesalers.[53]

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[51] At the margin, an out-of-state winery's incentives to comply may be lower for another reason as well. To the extent that non-compliance imposes negative externalities on others – injuries or fatalities caused by sales to underage consumers who drink and drive, for example – the winery is less likely to bear the cost of the externality than is an in-state winery. Moreover, the out-of-state winery may be less likely to suffer reputational damage if such accidents occur. Moreover, other things equal, the smaller a winery's shipments are, the lower the probability (a) that any cheating will be detected and (b) that New York (or, for that matter, any local jurisdiction) would incur the costs to detect or prosecute any violation. As a consequence, those wineries' incentives to comply are likely to be even lower.

[52] The state's costs of enforcement and compliance differ for in-state and out-of-state wineries, so it is quite logical for the state to impose different regulations.

[53] In this respect, the rise of the Internet has, if anything, increased the state's cost of monitoring and policing, since web-based transactions are typically less transparent.

VI. Dr. Robert Eyler's Affidavit

44. Counsel for Defendants have also asked me to evaluate various issues raised in the affidavit of Dr. Robert Eyler. In this section, I consider three parts of Dr. Eyler's analysis: (i) his theoretical model, through which he claims to show that New York's ban on direct shipping "reduces the competitive forces in the New York market, thus raising price and lowering welfare;"[54] (ii) his claim that "[o]ut-of-state wines . . . must pass through the distributor's monopolistic filter, which artificially restricts entry to certain out-of-state firms;"[55] and (iii) his Tables 1-3 and the associated discussion, in which he compares wine prices in New York to those in various others states.

A. Dr. Eyler's Theoretical Model

45. In sections II and III of his affidavit, Dr, Eyler discusses "The Economics of Direct Shipping as Free Trade" and "The Economies of Non-Tariff Barriers to Trade." Those sections, he suggests, help "demonstrate that the direct shipping law leads to a second-best outcome than observed [sic] under free trade and should be repealed."[56] In fact, Dr. Eyler's *theoretical* discussion is just that: By ignoring potentially important real-world aspects of the wine industry, he virtually guarantees the conclusion he hopes to reach. Indeed, by adopting simplistic assumptions about

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[54] Eyler Affidavit, ¶ 16.

[55] Eyler Affidavit, ¶ 15.

[56] Eyler Affidavit, ¶ 11. As noted below, in light of the externalities generated by wine consumption, the wine market is one in which a completely free market would yield suboptimal results. Hence Dr. Eyler's suggestion, that repealing the direct shipping law would improve welfare, does not follow.

the industry, he ignores well-established principles of economic theory that undermine his conclusions.

46. Ultimately, Dr. Eyler's argument hinges on the benefits of free trade and his claim that any intervention necessarily reduces societal welfare. He states, for example,

> Free trade is at the foundation of any capitalist nation. Adam Smith's 'Invisible Hand' idea is the beginning of competition in economics, an idea that individual incentives on the part of both consumers and firms drive society . . . to a first-best outcome in terms of benefits derived from exchange. If allowed to act free of governmental intervention and monopolization of the good's supply, markets are allocatively efficient by maximizing societal welfare.[57]

47. Although Adam Smith's discussion of the invisible hand in 1776[58] may be "the beginning of competition in economics," it is certainly not the last word on the subject in the last 225 years. Any reputable, introductory textbook discusses the caveats and limitations of claims about the benefits of completely free trade. Consider, for example, the following excerpt from Samuelson and Nordhaus' *Economics*:

> Smith's insight about the functioning of the market mechanism has inspired modern economists – both the admirers and the critics of capitalism. After two more centuries of experience and

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[57] Eyler Affidavit, ¶ 5. See also similar statements about the benefits of free trade in Eyler Affidavit, ¶ 6, and Deposition of Robert Eyler, June 14 and 15, 2001 ("Eyler Deposition"), p. 10.

[58] Adam Smith; *The Wealth of Nations* (1776).

> thought, however, we recognize the scope and realistic limitations of this doctrine. We know that the market sometimes lets us down, that there are 'market failures,' and that markets do not always lead to the most efficient outcome. One set of market failures concerns monopolies and other forms of imperfect competition. A second failure of the invisible hand comes when there are spillovers or externalities outside the market-place – positive externalities such as scientific discoveries and negative spillovers such as pollution. . . .[59]

48. Social losses from monopoly, of course, underlie the antitrust laws of the US and similar competition statutes of other countries. Dr. Eyler certainly recognizes that the presence of a monopoly violates the conditions needed to invoke Adam Smith's doctrine of the invisible hand. In fact, he assumes, without any basis, that wholesale distribution of wine in New York is monopolized – an issue to which I turn in the next section.

49. On the other hand, Dr. Eyler does not even mention externalities in his affidavit. While economists

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[59] Paul Samuelson and William D. Nordhaus, with the assistance of Michael J. Mandel, *Economics*. 15th ed. (New York: McGraw-Hill, Inc., 1995), p. 27. In 1970, Professor Samuelson became the first American to win the Nobel Prize in economics; the prize was first awarded in 1969. Professor Nordhaus has been a Full Professor of economics at Yale University since 1973. He is a member of the National Academy of Sciences and a Fellow of the American Academy of Arts and Sciences, was a member of the U.S. President's Council of Economic Advisers, and has served as Provost (1986-1988) and Vice President for Finance and Administration (1992-1993) of Yale University. Among his many other honors and affiliations, Professor Nordhaus is also a member of the research staff of the Cowles Foundation and of the National Bureau of Economic Research. (www.econ.yale.edu/~nordhaus/homepage/homepage.htm)

have written numerous articles about various aspects of externalities and their regulation, the essence of the problem is straightforward: When there are "spillovers or externalities outside the marketplace," market prices do not reflect all of the costs or benefits of market participants. A factory that freely pollutes the water in a river downstream takes no account of its actions and the costs it imposes on others. Since the free market does not "charge" either the firm or its customers for those costs – the firm doesn't pay for cleaning up the river, and the prices paid by consumers do not reflect the damage to the environment – the firm's output exceeds the socially optimal level. In that case, the unregulated market fails; hence the term "market failures," alluded to in the quotation above.

50. In explaining how and why free markets may fail, Samuelson and Nordhaus elaborate on externalities:

> A second type of inefficiency arises when there are spill-overs or externalities which involve involuntary exchanges of costs or benefits. Market transactions involve voluntary exchange in which people exchange goods or services for money. . . .
>
> But many interactions take place outside markets. While airports produce a lot of noise, they generally do not pay the people living around the airport for the use of the airspace above their homes. . . .
>
> Externalities (or spillover effects) occur when firms or people impose costs or benefits on others outside the marketplace.
>
> Governments are today often more concerned with negative externalities than positive ones. As our society has become more densely populated

> and as the volume of production of energy, chemicals, and other materials increases, negative externalities or spillover effects have grown from little nuisances into major threats. This is where governments come in. Government *regulations* are designed to control externalities like air and water pollution, strip mining, hazardous wastes, unsafe drugs and foods, and radioactive materials.
>
> . . . Finding the exactly correct regulations is a difficult task, requiring complex science and economics, and subject to heavy political pressure, but few today would argue for returning to the unregulated economic jungle where only might makes right.[60]

51. Although Dr. Eyler does not mention externalities anywhere in his affidavit, he did agree at his deposition that the appropriateness of government intervention to deal with externalities depends on the sum of positive and negative externalities.[61] He also acknowledged that "[I]n a practical sense, I'm sure there are a myriad of problems, but I couldn't articulate any of them to you in an expert way."[62] But instead of considering what those externalities might be, Dr. Eyler simply *assumed* that they sum to zero:

> Q: Did you think you would have to consider externalities as part of your analysis?
>
> A: Not when I started with a competitive equilibrium, no, because in a competitive

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[60] Samuelson and Northam, *op. cit.*, p. 32.

[61] Eyler Deposition, pp. 44-45.

[62] Eyler Deposition, p. 31.

equilibrium there are no externalities by assumption, the market takes in all benefits and costs to the society at one time.

Q: You assumed there were no externalities at all when you did this market analysis?

A: I *assumed* the positive and negative externalities net to zero.

Q: To reach that equation, did you try to assess what the positive and negative externalities were?

A: No, that's beyond the scope of my knowledge.

Q: So you didn't even consider any particular externality in what the societal cost would be?

A: No.

. . .

A: I *assumed* the positive and negative externalities, if they existed, would net out to zero.[63]

Dr. Eyler reiterated that assumption at several other points in his deposition.[64] At one point, for example, he stated that he "started with the idea that any positive or negative I could not quantify as an economist there on the

[63] Eyler Deposition, pp. 31-32 (emphasis added).

[64] See, *e.g.*, Eyler Deposition, pp. 41-42, 44-45, 142-143, and 146 for similar statements.

spot, so I *assumed* them to be the sum of equal to [sic] zero."[65]

52. While I understand that other experts will testify about the negative externalities caused by unregulated wine sales, it is not hard to infer the source of at least some of those externalities. Most notably, unregulated purchases by minors could well impose costs on society that are not borne by the suppliers or purchasers themselves. (*e.g.*, injuries or deaths caused by intoxicated drivers) – costs that are not reflected in the price suppliers charge and purchasers pay and that impose external effects on others. Direct shipments from numerous out-of-state wineries, over which New York State has more limited jurisdiction and control than it has over in-state wineries, would only increase the likelihood that such negative externalities would occur and would not be controlled.

53. By making additional assumptions, however, Dr. Eyler simply excludes the possibility of underage or binge drinking, let alone any negative externalities it might cause:

> I assumed that . . . the only participants on the demand side were legal buyers. If there are illegal buyers of wine, they are insignificant to a point that I could *assume them away* in the generalization . . .[66]

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[65] Eyler Deposition, p. 52 (emphasis added).

[66] Eyler Deposition, p. 35 (emphasis added).

> I should say it's an over riding [sic] assumption of the model that only those over 21 participate in the model and participate in the market.[67]

Moreover, although Dr. Eyler's affidavit seems to suggest that he opposes any government intervention,[68] he manages to explain why laws setting the minimum drinking age at 21 do not constitute intervention: "It's not a governmental intervention as we have defined it. It restricts who is the demand, not the quantity of the demand."[69]

54. Although it may be difficult to enumerate and quantify all the sources of externalities in this industry, measurement problems and arbitrary definitions do not imply that such externalities do not exist; that they are insubstantial; or that in any case, they are cancelled by positive externalities. Indeed, any assumption that net externalities are zero, while convenient, is unfounded. Policy conclusions based on such an assumption – including Dr. Eyler's conclusion that any government intervention would reduce societal welfare[70] – are no better than the assumptions on which they depend: Without factual support, such policy conclusions are unfounded.

55. As I have already noted (see section IV above), there are no effective impediments to access in the New

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[67] Eyler Deposition, p. 38. Asked where he stated that in his affidavit, Dr. Eyler replied, "I *assumed* it, I didn't say it anywhere." (emphasis added)

[68] "Any policy-driven deviation from market equilibrium, where the supply and demand for a good or service came together to find price and quantity in a market, is detrimental to societal welfare." (Eyler Affidavit, ¶ 16).

[69] Eyler Deposition, p. 35.

[70] Eyler Deposition, p. 10.

York wine industry. The state's ban on direct shipments from out-of-state wineries has not erected obstacles to out-of-state wineries' ability to sell to New York consumers or to consumers' ability to buy wine produced outside New York. In any attempt to balance the benefits and losses from government intervention, therefore, the benefits of reducing even small negative externalities could easily justify such government intervention. Dr. Eyler is simply wrong when he claims that "[t]he positive economic outcomes from direct shipping are unambiguous."[71] The allegedly "unambiguous" benefits from direct shipping simply reflect his *assumption* that there are no externalities.

B. Dr. Eyler's Claims about the "Monopolistic Filter" of Wholesale Wine Distribution in New York

56. Dr. Eyler claims in his affidavit that "[o]ut-of-state wines . . . must pass through the distributor's monopolistic filter, which artificially restricts entry to certain out-of-state firms."[72] That characterization of wholesale wine distribution in New York, however, betrays his lack of familiarity with the data, his incorrect understanding of the term "monopoly," and his failure to consider the conditions of entry into wholesale distribution of wine in New York.

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[71] Eyler Affidavit, ¶ 14.

[72] Eyler Affidavit, ¶ 15.

1. Dr. Eyler's Estimate of the Number of Wholesalers in New York

57. When asked how many New York wholesalers there are, Dr. Eyler replied, "I would say there is [sic] between seven and ten."[73] In fact, there are far more New York wholesalers than Dr. Eyler thinks.[74] Plaintiffs' own submissions in support of their motion for summary judgment include a 12-page list of 230 "Licensed Wine Wholesalers in New York State" provided by the Division of Alcoholic Beverage Control of the New York State Liquor Authority.[75] According to Plaintiffs' expert Hans Stern, the number is even greater: "The Bureau of Alcohol, Tobacco and Firearms records show that in December 2000 there were 825 wholesale licenses issued in New York."[76] Needless to say, those numbers greatly exceed Dr. Eyler's estimate of seven to ten wholesalers.[77]

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[73] Eyler Deposition, p. 197.

[74] There are also many more New York wholesale licensees than Plaintiffs' expert John Dyson is aware of. Mr. Dyson, who holds a majority interest in Pebble Ridge Vineyard, a licensed New York wholesaler, said he "would he surprised if there were more than ten or twelve" parties licensed to engage in wholesale distribution of wine in New York State. (Dyson Deposition, p. 182)

[75] See the August, 2, 2000 letter from Maris C. Hart, Deputy Commissioner of the Division of Alcoholic Beverage Control, and the attached list, which are part of Exhibit S of plaintiffs' submission.

[76] Affidavit of Hans L. Stern ("Stern Affidavit"), ¶23, Mr. Stern found it "[s]urprising, but not relevant," that the number had grown from 728 in 1970 to 825 in 2000 (Stern Deposition, pp. 277-280); nonetheless, such numbers hardly indicate the presence of barriers to entry into wholesale distribution.

[77] When informed of Mr. Stern's estimate, Dr. Eyler stated, "That would shock me, but I don't know his source of data." Asked where he got *his* information about the number of New York wholesalers, Dr.

(Continued on following page)

2. Dr. Eyler's Incorrect Use of the Term "Monopoly"

58. Even if Dr. Eyler's estimate were correct – and it certainly is not – it would be wrong to characterize the wholesale tier as a monopoly. As Samuelson and Nordhaus explain, for example,

> . . . [a] monopoly [is] a single seller with complete control over an industry. [fn. – It is called a 'monopolist,' from the Greek words *mono* for 'one' and *polist* for 'seller.'] It is the only one producing in its industry, and there is no industry producing a close substitute.[78]

Even if there were only seven to ten New York wholesalers, there certainly would not be "a single seller with complete control over [the] industry."[79] I know of no economist who would refer to an industry with seven to ten firms as a monopoly.[80] Furthermore, neither Dr. Eyler nor any other expert has claimed that New York wholesalers collude and act as a joint monopolist, and I am not aware of any evidence to support such a notion.

Eyler replied, "I gleaned it from industry sources and just over time I know, I have heard." (Eyler Deposition, p. 198)

[78] Samuelson and Nordhaus, *op. cit.*, p. 150. Similar definitions appear in other introductory textbooks.

[79] For the same reason, of course, Dr. Eyler's reference to a single distributor in his affidavit ("distributor's monopolistic filter") is inconsistent with his own estimate of the number of wholesalers.

[80] Indeed, some economists would argue that seven to ten firms may be enough to ensure that an industry's performance is workably competitive. A recent article on the wireless industry noted, "With *six* national carriers competing fiercely, it is all too easy for customers to jump to another company." (Andrea Petersen, "Battle to Improve Cellphone Service Continues as Quality Is Still an Issue," *The Wall Street Journal*, July 23, 2001, p. B1, emphasis added)

59. In reaching his conclusion that wholesale distributors in New York impose a "monopolistic filter" on wine distribution, Dr. Eyler apparently relies on an incorrect understanding of the term "monopoly," as the following exchange demonstrates:

> Q: So anything you sell gives you a monopoly in the sale of that product to some degree?
>
> A: Sure.
>
> Q: So everybody has a monopoly?
>
> A: That's the beauty of doing business.
>
> Q: So every business in America is a monopoly to some degree?
>
> A: To some degree, sure.
>
> Q: That's what you're trying to convey to the court here, because wholesalers are selling something, they have a monopoly power over what they sell?
>
> A: They may have a very small amount, but yes. Basically market structure in economics boils down to competitive and non-competitive. *Monopoly is a general term for non-competitive market structures.*[81]

I know of no economist who would agree that "monopoly is a general term for non-competitive market structures." Economists define "monopoly" in a straightforward and simple way – see, *e.g.*, the definition cited in the text above – and Dr. Eyler's usage is *not* consistent with the standard definition.

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[81] Eyler Deposition, pp. 209-210 (emphasis added).

3. Dr. Eyler's Failure to Analyze Entry Conditions

60. Even in markets in which incumbent firms have large market shares, economists agree that those firms cannot exercise market power unless there are, at a minimum, effective impediments to entry into or expansion within the market.[82] Without such impediments, new firms will enter the industry and existing participants will expand their presence, which would constrain any attempt by an incumbent firm to take advantage of its large share.

61. To the extent that Dr. Eyler has considered entry conditions at all, his analysis relies on faulty premises. In his affidavit, for example, he claims:

> From the distributors' perspective, the beauty of having only two domestic sources of wine – distributors and New York wineries – combined with a direct shipping ban, is that new market entrants do not exist.[83]

Dr. Eyler's assertion that there are "only two domestic sources of wine" is misleading, at best. As I have already noted, there are hundreds of New York wholesalers, each licensed to distribute wine from numerous wineries.

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[82] Similarly, in guidelines outlining its approach to the analysis of the likely effects of mergers, the Department of Justice states, "A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels." (1992 Horizontal Merger Guidelines [with April 8, 1997, Revisions to Section 4 on Efficiencies], revised April 8, 1997, §3.0, available at http://www.usdoj.gov/atr/public/guidelines/hariz_book/hmg1.html)

[83] Eyler Affidavit, ¶ 13.

Similarly, there are, of course, numerous New York wineries, as well as thousands of wineries outside New York State. I see no justification, therefore, for Dr. Eyler's claim that there are "only two domestic sources of wine."[84]

62. Moreover, as I have already noted, there are no effective impediments to entry into wholesale distribution of wine in New York. With numerous wholesale licensees available, wineries and retailers have numerous options from which to choose. Furthermore, without barriers to entry, there is no basis for Dr. Eyler's claim that "new market entrants do not exist."

63. In fact, Dr. Eyler apparently did not analyze very carefully either the conditions of entry into wholesale distribution in New York or the manner in which wholesalers operate. For example, he conceded that he does not know the legal requirements to become a wholesaler in New York, doesn't know what the barriers to entry are to wholesalers in New York, and doesn't know if there is any legal restriction that prevents an out-of-state winery from becoming a wholesaler in New York.[85] Remarkably, these obvious gaps in his analysis do not affect Dr. Eyler's conclusion, as the following exchange illustrates:

> Q: So without knowing what the barriers to entry are or how many wholesalers there are or what the competitive environment is among and between

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[84] I also see no justification for his focus in that statement on domestic wines only: Imported wines provide competition for domestic wines as well.

[85] Eyler Deposition, p. 200.

wholesalers, you would nevertheless describe them as having a monopolistic filter on sales?

. . .

A: Right.[86]

C. Dr. Eyler's Comparisons of Wine Prices in New York and in Other Groups of States

64. In an attempt to support his theoretical model, Dr. Eyler includes three tables in his affidavit, listing, for 1994-1998, "New York State Prices and Quantities for Table Wine. Off- and On-Premises" (Table 1), "Reciprocal State Average Prices, On- and Off-Premise" (Table 2), and "Non-Reciprocal States in the New England and Tri-State Areas" (Table 3). In a preview referring to the section in which he presents those tables, he states, "Comparisons with other states . . . show why this law should be repealed for society's economic betterment."[87] In fact, a more careful look at his data reveals that his price comparisons provide no support for his theory.

65. The problems with Dr. Eyler's empirical work stem ultimately from the highly aggregated price data he uses. His failure to control for any variables other than state importation laws only compounds his problems in any attempt to use the data to support his theoretical model. Numerous other factors (*e.g.*, differences in brand and/or varietal preferences, differences in on-premise vs. off-premise consumption, etc.) might explain differences among the states' prices, but he fails to account for them.

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[86] Eyler Deposition, pp. 211-212.

[87] Eyler Affidavit, ¶ 22.

66. In constructing his tables, Dr. Eyler uses 1994-1998 price data from MKF WineStats' "1998 U.S. Wine Report." For each state listed in his Tables 2 and 3, Dr. Eyler reports a single number for each year, the average retail revenue per nine-liter (9L) case equivalent. That single number, however, reflects the net effect of numerous factors that differ among the states. Because he fails to account for such factors or attempt to hold them constant in his analysis, Dr. Eyler cannot logically conclude that any difference he claims to observe between New York and other states stems from New York's ban on direct shipments from out-of-state wineries.

67. To understand why not, note first that Dr. Eyler's "price" data – actually, data on average revenue (*i.e.*, total revenue + total units) – at best reflect only prices that retailers charge their customers. Those prices depend on numerous factors that differ across the various states listed in his table – differences that have nothing inherently to do with the states' different laws on direct shipments of wine from out-of-state wineries. A consumer eating dinner in an upscale restaurant in New York City, for example, essentially faces a local monopoly: Having chosen to eat dinner at that restaurant, perhaps because of its reputation for fine cuisine, the consumer typically has no choice but to order wine from that restaurant (assuming that she wants to drink wine with her meal).[88] The New York restaurant might well pay very *low* prices

[88] The restaurant's wine list, of course, will inevitably include only a subset of wines that are produced, a fact that does not apparently trouble Dr. Eyler: " . . . I don't think it's a good economic choice in my opinion to have a restaurant have a bottle of every wine produced in the world or in the United States for that matter." (Eyler Deposition, p. 234)

for wines it buys from wholesalers, and it might then add very high markups in setting its retail prices.[89] If so, the retail price of the wine would be quite high, but it would not reflect any alleged "monopolistic filter" at the wholesale level or any particular effect of New York's ban on direct shipments from out-of-state wineries. Nonetheless, by relying on MKF's retail "price" data, Dr. Eyler would apparently attribute that high price to New York's ban on direct shipments, even though comparisons of retail prices in different states would shed no useful information on the effect of the states' different laws on direct shipping.

68. There are, of course, other reasons that a restaurant might charge relatively high retail prices for wine. As Plaintiffs' expert Hans Stern notes, for example, New York City restaurants can be particularly hard to service: "The logistics of obtaining orders, delivery, and collection from the thousands of Manhattan restaurants makes for a difficult and expensive task"[90] – an issue that Dr. Eyler was not aware of.[91] It would hardly be surprising to find that wholesalers dealing with such Manhattan restaurants set prices at levels designed to recover the high costs of the logistics of distributing to those restaurants – and that the restaurants in turn charge high prices for the wine they serve. But those prices would not reflect the effects of New York's ban on direct shipments. Wine prices

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[89] It is hardly surprising that the prices of many goods and services in New York City are quite high relative to prices elsewhere: The cost of real estate and other inputs are higher than in many other areas, so retailers' long-run viability depends on their ability to charge prices that are high enough to cover their costs.

[90] Stern Affidavit, ¶ 24.

[91] See Eyler Deposition, pp. 162-163.

in New York City, of course, affect the average price that Dr. Eyler reports for New York. High retail prices in New York City, therefore, certainly provide at least part of the explanation for Dr. Eyler's finding (in his Table 2) that the average price in New York exceeds the average price in Idaho, for example.

69. Differences in shipping and handling costs might also account for part of the differences between prices in different states. Most US wine is produced on the west coast, and only one of the reciprocal states listed in Dr. Eyler's Table 2 (reciprocal states) is located on the east coast;[92] all of the states in his Table 3, by contrast, are on the east coast. Dr. Eyler, however, "*assume[d]* the cost difference [for shipping to different states] is negligible,"[93] so he did not account for differences in shipping costs. Note, however, that MKF WineStats' "1998 U.S. Wine Report," the source of Dr. Eyler's data, itself cited "lower shipping costs" as one of the reasons prices are lower in the Pacific Region than they are elsewhere.[94]

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[92] The one exception is West Virginia.

[93] Eyler Deposition, p. 150 (emphasis added).

[94] MKF WineStats, "1998 U.S. Wine Report" (St. Helena, CA: Motto Kryla & Fisher LLP, 1999), p. 4, Plaintiffs' expert John Dyson, who owns majority interests in wineries in New York, California, and Italy as well as a licensed New York wholesaler, stated, "There is a difference [in distribution costs] the farther away you go from the port of entry or the location of production, of course." (Dyson Deposition, p. 140) Discussing wine sold by Millbrook, his New York winery, Mr. Dyson said he believes that the retail price in California "is somewhat higher [than in New York] reflecting the transportation cost, which gets factored into all of these markups." (Dyson Deposition, p. 181) In an exchange about wine he imports into New Jersey from Villa Pillo, the Italian winery in which he has a majority interest, Mr. Dyson estimated those extra costs:

(Continued on following page)

70. Because the MKF "prices" on which Dr. Eyler relies are weighted average prices for each state, there are other reasons to question the validity of his cross-state comparisons. More specifically, the prices he reports for each state in his Tables 2 and 3 are weighted averages of the on- and off-premise average retail prices for that state, where the weights are the fractions of total wine consumption that are on and off premises, respectively. For New York, for example, MKF reports on- and off-premise wine consumption of 3,116,000 and 14,908,000 nine-liter case equivalents, respectively; total consumption, therefore, was 3,116,000 ÷ 14,908,000 = 18,024,000 nine-liter case equivalents. Average retail prices were $182.80 (on-premise) and $65.54 (off-premise). The weighted average price for New York, therefore, was

$$(3{,}116{,}000/18{,}024{,}000)(182.80) + (14{,}908{,}000/18{,}024{,}000)(65.54)$$
$$= (0.1729)(182.80) \div (0.8271)(65.54)$$
$$= \$85.81$$

The average prices Dr. Eyler reports for other states reflect analogous computations of weighted averages.

Q: And what percentage of the wholesale price you charge California would be attributable to those extra delivery costs associated with having to get the product from New York or the port of New Jersey out to California?

A: I'd say $4 dollars [sic] or $5 a case perhaps. So –

Q: That would be 5%?

A: 5%.

(Dyson Deposition, pp. 140-141)

71. But the use of such weighted averages further undermines Dr. Eyler's cross-state comparisons of average prices. By using such weighted averages, he fails to compare apples to apples and oranges to oranges. To understand why, consider the following table, which includes data for Illinois and West Virginia, two of the reciprocal states in Dr. Eyer's Table 2, as well as data for New York. All of the data in the table below come from MKF WineStats' "1998 U.S. Wine Report," Dr. Eyler's data source; the shaded data are those he included in his affidavit.

Table A

1998 Data

	9L Case Equivalents (000s)			Dollars/9L Case		
State	On-Premise	Off-Premise	Total	On-premise	Off-premise	Average
NY	3,116	14,908	18,024	$182.80	$65.54	$85.81
IL	1,179	9,592	10,771	$192.07	$67.89	$81.48
WV	44	424	468	$186.32	$67.22	$78.35

72. Note that *both* the on-premise and the off-premise prices in Illinois exceed their counterparts in New York. The (weighted) average price listed in the last column, however, is greater for New York than for Illinois. The explanation is straightforward: In New York, a larger fraction of total consumption takes place in on-premise facilities, so the *weight* on the on-premise price in New York is greater than the weight on the on-premise price in Illinois. Since the on-premise price is considerably higher than the off-premise price in *each* state, the higher weight on New York's on-premise price – and the correspondingly lower weight on the off-premise price, since the two weights must sum to one (1) – makes New York's weighted average price higher than Illinois'.

73. To see these points explicitly, consider the computation of the two states' (weighted) average prices:

Weighted average price for NY
= (3,116/18,024)($182.80) +
(14,908/18,024)($65.54)
= (0.1729)($182.80) + (0.8271)($65.54)
= $85.81

Weighted average price for IL
= (1,179/10,771)($192.07) +
(9,592/10,771)($67.89)
= (0.1095)($192.07) + (0.8905)($67.89)
= $81.48

The difference in weights for the two states shows up most clearly on the second lines of the two computations above. In New York, the weight on the on-premise price ($182.80) is 0.1729 (17.29%); in Illinois, on the other hand, the weight on the on-premise price ($192.07) is only 0.1095 (10.95%). Since the two weights must sum to one (1) for each state, the weight on the off-premise wine price, a

price that is considerably lower than the on-premise price in each state, is higher in Illinois than in New York. Thus, although Illinois' on-premise price per nine-liter equivalent is more than $9 greater than New York's *and* Illinois' off-premise price is more than $2 greater than New York's, the weighted average price – the price Dr. Eyler reports in his Table 2 – is actually higher in New York. Even if the differences between New York's and Illinois' laws on direct shipments were the only differences between them – and even if the removal of New York's ban on direct shipments caused New York's on- and off-premise prices to match their corresponding levels in Illinois – it is hard to see why New York consumers would be better off: In that scenario, both on- and off-premise prices would actually *increase* after the removal of the ban.[95]

74. The same relationships hold for the comparison of prices in New York and West Virginia: Although West Virginia's on-premise price *and* off-premise price exceed their New York counterparts, the weighted average price – the price Dr. Eyler reports in his Table 2 – is actually higher in New York.[96] By comparing weighted average

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[95] Dr. Eyler's conclusion in ¶29 of his affidavit reflects similar logical flaws: "If, for illustrative purposes, we assume that the wine price in the average reciprocal state would be the price in New York after the direct shipping law was repealed, consumers and society unambiguously gain."

[96] In the computation of the weighted average price for West Virginia, the weight on the on-premise price is only 9.40% (44/44+424) = 0.0940); the weight on the off-premise price is 90.60% (424/(44+424) = 0.9060).

prices across states, therefore. Dr. Eyler is not comparing apples to apples.[97]

75. Of course, the problems with Dr. Eyler's empirical approach run much deeper. Even the on- and off-premise prices reported for each state are highly aggregated weighted averages. The on-premise price for any particular state, for example, is the weighted average of retail prices for all wines bought at all kinds of on-premise facilities, including restaurants of all kinds (where drinking wine is legal), wineries (tastings), bars, and so forth. Those prices may vary for many reasons having nothing to do with a state's stance on direct shipping, including for example, whether the consumer bought a glass, a bottle, or a case (the price per liter is typically greater for a glass than for a bottle and greater for a bottle than for a case); whether the state's laws partition on-premise and off-premise establishments from each other; days and hours of business, and so forth.

76. More fundamentally, there is no reason to believe that the particular wines that enter into the computations of two states' average prices are the same, as Dr. Eyler himself admitted at his deposition:

> Q: . . . the comparison between states is not of the same wines, is it?
>
> A: I have no idea if they are of the exact same wines. I made a general statement there that the wines available to distributors in other states would probably be the same

[97] For further discussion of some of these issues, see the discussion at Eyler Deposition, pp. 172-175.

> wines essentially available to distributors in New York.
>
> Q: You made that assumption?
>
> A: I made that assumption.[98]

It is clear, therefore, that Dr. Eyler's Tables 1-3 do not address the issue he himself raised in his affidavit: "One of the main issues to be addressed below is whether New York prices are higher or not than in states without this law *for the same wines*"[99] When questioned about that statement, Dr. Eyler conceded:

> So the word same may be a little strong, but I think that as far as the model goes, the conclusions would not be different in whether the mix was different.[100]

77. In light of the many defects in his empirical approach, Dr. Eyler's admission at his deposition – "I did not try to draw conclusions from the data"[101] – is hardly surprising. Indeed, it is quite appropriate: His flawed empirical analysis does not permit him – or anyone else, for that matter – to draw any conclusions.[102]

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[98] Eyler Deposition, p. 180.

[99] Eyler Affidavit, ¶12 (emphasis added).

[100] Eyler Deposition, p. 321.

[101] Eyler Deposition, p. 181. See also p. 170, where Dr. Eyler states: "I'm not trying to prove it with the data, I'm trying to be illustrative of what may be happening. *Theoretically speaking*, the conclusions would be the same regardless." (emphasis added)

[102] When asked how he would explain why the price of wine has risen more dramatically in California than it has in New York in recent years, Dr. Eyler indicated that there were many factors he might want to consider: ". . . it could be simply that in California there is more demand than in New York, suddenly there has been a surge, there has

(Continued on following page)

VII. Conclusion

78. In light of the foregoing, it is clear that, by any reasonable economic test, the wine market in New York State is one in which competition is open, intense, and effective, and in which access – for both suppliers of wine and consumers of wine – is unimpeded. That some suppliers and/or consumers may prefer to conduct business in a certain manner that is not directly available to them does not affect this conclusion: Few if any markets provide an unlimited number of channels of production, distribution, and/or purchase for any and all who wish to participate.

79. Plaintiffs' experts' views are simply beside the point: They postulate circumstances that either bear no resemblance to the realities of the market at issue or, in their focus upon isolated individuals, fail to consider the prevailing economic characteristics of the market. To repeat, this is a market replete with realistic alternatives available to consumers, and there are no realistic impediments for wineries of any size or location to compete for the patronage of those consumers.

/s/ Howard P. Kitt
Howard P. Kitt

[sic] been income changes, . . ." "I would have to look at the macroeconomic data for California and New York and compare them." "I would say that if I was given the chance, I would use the interest rates, the prices, the unemployment rate, gross state products, . . ." In using MKF's data to compare the *levels* of different states' prices, however, Dr. Eyler said "you could" use such data or "you could just assume that relatively speaking the differences don't really matter much to the pricing, that it's industry specific rather than macroeconomic, but it would be good to confirm that." (Eyler Deposition, pp. 255-257)

Subscribed and sworn to before
me this 16th day of August, 2001

/s/ A. Andrew Hund
Notary Public

My commission expires 6/26/02

A. ANDREW HUND
Notary Public, State of New York
No. 01HU6043948
Qualified in New York County
Commission Expires June 26, 2002

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted in Printing]

Affidavit of Henry Wechsler,
sworn to on August 10, 2001, in Support of
Defendants' Cross-Motion for Summary
Judgment and in Opposition to
Plaintiff's Motion for Summary Judgment,
dated August 17, 2001

STATE OF MASSACHUSETTS)
) SS:
COUNTY OF NORFOLK)

HENRY WECHSLER, being duly sworn, deposes and says:

1. I, Henry Wechsler of Quincy, Massachusetts, have been asked to provide expert testimony on behalf of the Attorney General of New York State in this case. I am testifying in opposition to changing the current system of alcohol distribution and sales in New York so as to allow direct sales from out-of-state suppliers to New York residents through mail, telephone, and Internet orders. I oppose this change because in my expert opinion it would increase the access of underage youth to alcohol, weaken the current system of controls over underage drinking, and increase underage drinking and the resulting harms. This is the first time I am providing expert testimony despite numerous requests to do so over the years. I am doing so because this is such an important issue.

2. I am a public health researcher specializing in studies of alcohol use and problems among young people. My experience and scholarly work in this field are reflected in

my current curriculum vitae, which I have enclosed as exhibit A.

3. I received my Ph.D. degree in social psychology from Harvard University and have been on the faculty of the Harvard School of Public Health since 1966. I have regularly taught courses there on "Alcohol Abuse and Alcoholism from a Public Health Perspective" and "An Introduction to High Risk Behaviors: Epidemiology and Prevention and Public Policy." I have also held appointments as Adjunct Professor at the Boston University School of Public Health and the Simmons College School of Social Work. I was Research Director and Associate Executive Director of the Medical Foundation Inc. in Boston.

4. I have published 17 books and monographs and more than 150 articles in professional journals including the Journal of the American Medical Association, the New England Journal of Medicine, the Journal of Studies on Alcohol, the American Journal of Preventive Medicine, the American Journal of Public Health, and the Journal of the American College Association. I am a member of the National Institute on Alcoholism and Alcohol Abuse Special Task Force on College Drinking, and I have consulted with a number of colleges and state agencies about student alcohol issues. In Massachusetts I was a consultant to the Governor's Alliance Against Drugs. I have been a keynote speaker at a number of national and state organizations including the American Society of Addictive Medicine, the New York State College Consortium in Alcohol and Other Drugs, the National Conference of State Liquor Administrators New Jersey Summit, the Mother's Against Drunk Driving College Commission, the Association for Medical Education and Research in

Substance Abuse, the American Society of Addiction Medicine, the National Association of Student Personnel Administrators, the National Alcohol Beverage Control Association National Alcohol Education Symposium, and the Association of American Colleges and University Program for Health and Higher Education. I also lecture nationally to college administrators, college health personnel and students about binge drinking and other forms of high risk behavior. I am the recipient of the American College Health Association's Clifford B. Reifler Award for my research contributions.

5. I published my first study on the topic of alcohol use in 1969, and since then have published over 50 research articles in professional journals on alcohol and substance abuse. In the 1970s, when most attention was placed on marijuana and other illicit drug use, my research pointed to the greater prevalence and harms resulting from alcohol abuse.

6. I am perhaps best known for my work as the Principal Investigator of the Harvard School of Public Health College Alcohol Study, an ongoing survey of a nationally representative sample of 14,000 students at 119 four-year colleges in 40 states. The first landmark study, published in 1994, focused national attention on the problem of "binge drinking" on college campuses and on the harmful, "second-hand" effects on other students.[1] The wide dissemination of this study's results has led to the strengthening of efforts on college campuses and home communities to reduce the heavy levels of use among college students.[2]

7. The role that public policy plays in affecting the levels of underage drinking and the harms that are associated

with this problem is a central part of the study. My own research has pointed to college students' relatively easy access to large supplies of alcohol, and the relationship of such access to student "binge" or heavy drinking.[3] In that study two of the strongest predictors of binge drinking among underage students were ease of access and low price per drink.

The Minimum Drinking Age

8. Perhaps the most effective countermeasure against youthful drinking and the problems that it engenders is the 21-year minimum drinking age. In 1984 the passage of the national Uniform Drinking Age Act led to the adoption of the minimum legal drinking age (MLDA) of 21 in all states. Since 1975, the National Highway Traffic Safety Administration estimates that the MLDA of 21 has saved over 19,000 lives among persons in accidents involving drivers 18 to 20 years of age – 900 in 1999 alone, reducing fatalities by about 13%. The proportion of youth fatalities that were alcohol related dropped from 63.2% in 1982 to 35.1% in 1999.[4]

9. Studies of highway fatalities when the MLDA in most states was lowered in the 1970's revealed a similar increase in deaths during that time period.[5]

Underage Alcohol Use

10. While the effect of the MLDA has been positive, underage alcohol use remains a serious national problem. Enforcement is often lax, and the agencies involved are under-funded in many states.[6] Fake IDs and the provision of alcohol to underage persons continue to present serious

enforcement problems. Studies of drinking establishments show that compliance needs to be improved.[7]

11. Today even with the improving situation attributed to the MLDA law, more than half of 8th graders and four of five high school seniors have tried alcohol. One in two high school seniors and two in three underage college students reported consuming alcohol in the past month.[8] Among college students, those who were underage reported drinking on fewer occasions than their of-age classmates. When they drank, however, underage students drank more alcohol per occasion.[3]

12. This is the essence of the problem with underage drinking in the United States. Thirty percent of high school seniors, or more than half of those who drank, reported consuming five or more drinks in a row, an amount associated with alcohol related problems. Two in five underage college students drank five or more drinks in a row, compared to only one in four of-age students. Even among 8th graders, 15% reported drinking five or more drinks in a row. These levels of heavy drinking characterize the prevalent manner in which underage students drink.[8]

13. As a result, it is not surprising that underage drinking is associated with high levels of morbidity and mortality. In 1999 over 2,000 youth died in alcohol related crashes.[4] While raising the MLDA has contributed to a gradual decrease in alcohol related fatalities under current levels of enforcement, automobile fatalities involving drinking drivers are still the number one cause of death among persons under 21. In addition to traffic fatalities, underage drinking is a major factor in unintentional injuries from burns and falls, violence and crime, and

suicide. Fetal alcohol syndrome and alcohol poisonings are among the direct consequences of such drinking.[9] Heavy drinking among young people has also been associated with unsafe sexual practices through lower levels of condom use.[10]

14. In my own research, frequent binge drinkers were found to be ten or more times more likely to get into trouble with the police, be involved in verbal or physical violence, vandalize property, or become hurt or injured.[11]

15. All in all, it is estimated that underage alcohol use costs the nation more than 50 billion dollars per year.[9] Underage drinking also poses a potential to alcohol problems later in life. The earlier the age of the first drink or intoxication, the greater the likelihood of alcohol problems in adult life, and of alcohol related injuries from automobile collisions.

16. As widespread as these consequences of underage drinking are today, research findings suggest that they would increase dramatically if the MLDA was lowered or the current policies and levels of enforcement were decreased.

Enforcement Level

17. Where there are more controls over underage drinking – with more careful and frequent ID checks – drinking by this age group, and heavy drinking in particular, is lower. Community wide efforts to accomplish this have reported some success.[12-15]

Ease of access to alcohol

18. Ease of access to alcohol for underage students is a key factor in their drinking participation and in the number of drinks consumed per occasion. While research has shown that access to alcohol is relatively easy for most college students, underage students at colleges where it is easiest to obtain alcohol are more likely to binge drink and to experience higher rates of alcohol related problems.[3]

19. Studies have shown more drinkers and higher levels of drinking with increased hours of sale, days of sale, and with greater numbers of alcohol establishments in a geographic area or higher outlet density.[16]

State Alcohol Retail Sales Monopolies

20. Several states have made changes in the system of distributing alcohol. Researchers have studied the effects of privatization, the changeover to private sales from a system of state run retail monopolies in seven states as well as several Canadian provinces, and countries. The balance of evidence suggests that sales and consumption increases availability through major increases in the number of outlets, and changes in marketing practices, increasing hours and days of sale.[17-20] A review of the studies indicate that lower prices, and an increase in the volume of alcohol sold usually follow privatization. Lower prices have been found to be associated with higher consumption, and more binge drinking in other studies.[15]

Extending Alcohol Sales to Other Types of Outlets

21. Expanding the number of outlets by allowing sales of some forms of alcohol in other types of establishments –

such as groceries and fast food restaurants – has been found to be associated with more alcohol consumption and higher levels of outlet related problems.[21-23]

Outlet Density

22. Studies on the number of outlets in a region show a positive relationship to volume purchased, heavy consumption, and higher levels of alcohol related problems.[24-27] Some studies have found that rates of drunk and disorderly behavior, homicides, and automobile collisions are higher in areas where there are more alcohol outlets.[24, 28-30]

Hours and Days of Sale

23. Similarly, some studies have found that increasing the hours and weekend days that alcohol is sold is associated with more automobile collisions, more domestic violence, and more drunkenness.[31-36]

Home Delivery

24. Perhaps no other method of sale decentralizes control policies to the same extent as home deliveries. While such distribution of alcohol is permitted in some states, only one study was found examining the potential consequences of this system. About one in ten underage students reported utilizing this system of delivery and thus eluding ID checks.[37] These students tended to be the heaviest drinkers and were more likely to experience alcohol related problems. Furthermore, establishments providing home delivery more often sold alcohol in such large volume as kegs than other outlets.[37] This home delivery of alcohol in bulk to heavier

drinkers and potential party hosts poses new ways of circumventing the MLDA law.

Direct Sales of Alcohol Via Internet, Telephone, or Mail

25. While no studies have yet been reported regarding the effect of allowing alcohol to be sold directly over the Internet, telephone, or through the mail, what we know about the factors that affect underage drinking allows us to reach certain conclusions. In my expert opinion, changing the system of sales in New York by greatly increasing the number and type of suppliers who can sell alcohol products directly to New York consumers is likely to lead to a breakdown of controls over underage drinking. Even under the current system of controls which needs strengthening, the MLDA of 21 has resulted in a saving of 19,000 lives. Allowing delivery services to check ages of persons obtaining alcohol will increase the number of persons and sites involved in the control system, and consequently increase the chance of unintentional or intentional errors. Removing the possibility of face to face ID checks by trained personnel is at best a risky practice. Allowing direct sales is also likely to lead to more aggressive marketing practices and promotions, increasing the exposure of underage persons to stronger selling pressure. I also understand that those seeking this change argue that it will result in a drop in the price of alcohol in the long run, which in turn would, in my expert opinion, result in a subsequent increase in underage consumption. We should be strengthening the system of controls over underage drinking, and not weakening it. From a public health perspective, I view allowing the direct sale of alcohol through the Internet, telephone and mail to be a dangerous idea, and a bad public policy for any state such

as New York that wants to promote temperance, by increasing abstinence and decreasing heavy drinking among persons under the legal drinking age.

Direct Shipping by Certain New York Suppliers

26. I have been informed that New York State does permit certain in-state licensees to make direct shipments of alcoholic beverages to New York consumers in some cases. I strongly oppose these exceptions. However, I have also been informed that New York State does have the ability to control in-state shipments not present in the case of direct shipments by out-of-state sellers; for example, New York is able to hold in-state suppliers accountable for any violations of law because they are licensed by and present in New York State. I also understand that such violators may be subject to various civil and criminal sanctions, including sanctions under New York's Dram Shop Act. In any event, allowing all out-of-state suppliers to ship their products directly to New York consumers would, in my opinion, greatly increase the type and extent of problems far beyond those that may occur from direct shipments by a limited number of New York suppliers.

/s/ _____
Henry Wechsler

Subscribed and sworn to
before me this 10th day
of August, 2001

/s/ _____
Notary Public

My commission expires 7-2-2004

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Affidavit of Thomas G. McKeon, sworn to on August 17, 2001, in Support of Defendants' Cross-Motion for Summary Judgment and in Opposition to Plaintiff's Motion for Summary Judgment, dated August 17, 2001

AFFIDAVIT OF THOMAS G. McKEON

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

THOMAS G. McKEON, being duly sworn, deposes and says:

1. I am General Counsel to the New York State Liquor Authority ("SLA"), and report directly to the Commissioners of the SLA, who are defendants in this action (the "State SLA defendants"). I am personally familiar with the operations of the SLA as well as the laws and regulations pertaining to alcoholic beverage control in New York State. I submit this affidavit in support of the defendants' and intervenor-defendants' motion for summary judgment dismissing the complaint.

2. Plaintiffs challenge the right of the State of New York ("State") to enforce the prohibitions set forth in paragraphs (a), (c) and (d) of subdivision 1 of section 102 of the New York State Alcoholic Beverage Control Law

("ABC Law"). No other provision of the ABC Law is in issue (*see* Stipulation, dated March 28, 2001).

3. Because plaintiffs' challenge to ABC Law § 1-2 involves the scope of the State's legislative authority to regulate alcoholic beverages, it is appropriate to begin with the United States Constitution as the backdrop for the ABC Law.

4. The Eighteenth Amendment to the Constitution (the Prohibition Amendment) prohibited the importation of intoxicating liquors into the United States, and also prohibited the manufacture, sale, or transportation of intoxicating liquors within the United States. The Eighteenth Amendment was ratified on January 16, 1919, and became effective on January 16, 1920.

5. The Twenty-first Amendment to the United States Constitution, ratified on December 5, 1933, repealed the Eighteenth Amendment. Section 2 of the Twenty-first Amendment provides as follows:

> Amendment XXI. Repeal of Prohibition Amendment
>
> Section 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

6. Within the scope of the power reserved to the states by the Twenty-first Amendment, a state currently possesses the legal authority to enact a state law establishing, within the state's boundaries, as sweeping a prohibition against alcoholic beverages as the prohibition

which had formerly been established by the Eighteenth Amendment within the entire United States.

7. As an alternative to absolute prohibition, a state may elect (as did New York and many others) to enact legislation which permits the importation or shipment of alcoholic beverages into the state upon such terms and conditions as its legislature may find reasonable "for the protection, health, welfare and safety of the people of the state" (*see, e.g.*, ABC Law § 2 (McKinney 2000)). Because the traffic in alcoholic beverages is a business attended with danger to the community, a state, in the exercise of its police power, is fully competent to suppress such traffic in alcoholic beverages under such laws as will limit to the utmost its evils. *Crowley v. Christensen*, 127 U.S. 86, 91 (1980).

8. By enactment of Chapter 108 of the New York Laws of 1933, the New York State Legislature ("Legislature") created a temporary State Alcoholic Beverage Control Board to immediately deal with the changing circumstances surrounding the repeal of prohibition. In 1934, the Legislature enacted Chapter 478 of the New York Laws of 1934, creating the SLA and promulgating core provisions of the ABC Law. By doing so, the Legislature adopted in New York State a three-tier system for the importation and distribution of alcoholic beverages, much like that adopted in most other states following the repeal of Prohibition.

9. ABC Law § 2 expressly provides that it is "declared as the policy of the state that it is necessary to regulate and control the manufacture, sale and distribution within the state of alcoholic beverages for the purpose of fostering and promoting temperance in their

consumption and respect for and obedience to law" (ABC Law § 2). With respect to the many provisions contained in the statute, the Legislature stated (ABC Law § 2):

> The restrictions, regulations and provisions contained in this chapter are enacted by the legislature for the protection, health, welfare and safety of the people of the state.

10. The backbone of this new regulatory scheme, the three-tier system, has as its fundamental requirement that all sales within the State must be made to or by state-licensed entities. The three-tier system is the critical foundation of the regulatory scheme established by the State in 1934 and continued without interruption ever since. As applied to liquor, wine or beer, the three-tier system is designed to limit the power of distilleries, wineries and breweries in the marketplace; to prevent independent retailers from coming under the control of a manufacturer or wholesalers in a "tied-house" relationship; and to establish and maintain balanced, orderly markets for the distribution and sale of alcoholic beverages. Under the three-tier system, it is the wholesaler tier that is responsible for collecting and remitting to the State excise taxes on alcoholic beverages. (The taxation provisions relating to alcoholic beverages are now found in the New York Tax Law §§ 420, et seq.) The State's interest in the collection of tax revenues is thereby furthered by making the state-licensed wholesalers accountable for such tax revenues.

11. The ABC Law enacted by the Legislature permits commercial alcoholic beverage traffic under the regulatory supervision of the SLA, and in accordance with a comprehensive and carefully detailed regulatory scheme. The ABC Law sets forth, amount other things,

the policy and purpose of the statute; the powers of the SLA; the persons who are prohibited from receiving a license to engage in commercial alcoholic beverage traffic; the information which must be submitted to the SLA in connection with an application for a license; the civil and criminal penalties which may be imposed for a violation of the ABC Law; the acts which will constitute a violation; the various types of commercial alcoholic beverage traffic which will be permitted by the State; and the conditions and restrictions imposed in connection with each type of traffic the State elects to permit.

12. It is to the SLA that the Legislature has delegated the State's broad police power to regulate alcoholic beverages (ABC Law § 2):

> It is hereby declared that such [State] policy [to regulate and control alcoholic beverages] will best be carried out by empowering the liquor authority of the state to determine whether public convenience and advantage will be promoted by the issuance of licenses to traffic in alcoholic beverages, the increase or decrease in the number thereof and the location of premises licensed thereby, subject only to the right of judicial review. . . .

13. The SLA is composed of three Commissioners, one of whom is designated Chairman. The agency maintains offices in New York City, Albany, Buffalo, and Syracuse, and employs approximately 200 persons. Among the powers which the ABC Law specifically delegates to the SLA is the power to approve or disapprove any application for an alcoholic beverage license or permit provided for in the ABC Law (ABC Law § 17(1)), the power to limit the number of licenses (ABC Law § 17(2)); the power to

revoke, cancel, or suspend any license or permit for cause (ABC Law § 17(3)); the power to fix by rule the standards of manufacture and fermentation in order to insure the use of proper ingredients and methods in the manufacture of alcoholic beverages to be sold or consumed in the state (ABC Law § 17(5)); and to establish an alcoholic training awareness program to be used by schools and retailers (ABC Law § 17(12)).

14. The day-to-day activities of the SLA staff include the review and investigation of license applications, renewal applications, and permit requests; the investigation of alleged violations of law and SLA rules by alcoholic beverage licensees and permittees; working with local law enforcement agencies to ensure compliance with the ABC Law; the conduct of administrative disciplinary proceedings against licensees and permittees; and inspecting premises where alcoholic beverages are manufactured or sold (including the premises inspections resulting in the detection of underage patrons and false ID's).

15. The SLA regulates nearly 70,000 licenses and permits statewide each year. In 2000, the SLA issued over 6,500 new licenses, and issued more than 18,600 licenses in response to renewal applications. *See* 2000 SLA Annual Report (annexed hereto as Exhibit A) at 6. The SLA collected over $30.2 million in licensing revenues in 2000 and is one of the largest generators of revenue to the State Treasury. *See* 2000 SLA Annual Report at 6.

16. All those involved in the commercial manufacture, sale (wholesale and retail), storage, or transportation of alcoholic beverages in the State must obtain from the SLA a license (or permit), which confers to the

licensee or permittee the privilege of conducting a statutorily-defined type of alcoholic beverage business at a specific location within the State. *See*, *e.g.*, ABC § 100(1) (appropriate license required to manufacture or sell at wholesale or retail); ABC § 96 (warehouse license required for storage of alcoholic beverages in commerce); ABC § 94 (trucking permit required for transportation of alcoholic beverages in commerce).

17. Not all persons are eligible for an alcoholic beverage license. An individual person under twenty-one years is ineligible for a license (ABC Law § 126(2)). Only a United States citizen or an alien lawfully admitted for permanent residence may be issued a license (ABC Law § 126(3)). Persons convicted of a felony or certain specified misdemeanors are forbidden to hold a license (ABC Law § 126(1)). Persons who have had an alcoholic beverage license revoked are forbidden to hold a license for a period of two years from the date of such revocation (ABC Law § 126(5)(a)). Persons not holding an alcoholic beverage license who have been convicted of a violation of the ABC Law are forbidden to hold a license for a period of two years from the date of such conviction (ABC Law § 126(5)(b)). Employees of the SLA are forbidden to be licensed or to hold any interest in a license, licensed business, or licensed premises (ABC Law § 16). Police officers are forbidden to hold a license or be interested in a license or licensed business (ABC Law § 128). Pursuant to the tied house restrictions, the licensing requirements and application process are designed to detect, and prohibit, tied house arrangements where a manufacturer or wholesaler holds an interest in a retail license (ABC Law § 101).

18. The ABC Law provides for a rigorous license application process. Section 2 of the ABC Law requires the SLA to determine whether approval of a particular license application will serve public convenience and advantage. The extensive information gathered during the course of the application process is intended to insure that alcoholic beverage licenses will be granted only to persons of good character, for businesses and premises which will serve the public interest.

19. In addition to submitting information with regard to the specific disqualifications set forth in the ABC Law, an applicant for a license must also submit information from which the SLA may assess the applicant's overall character, fitness, experience, maturity, and financial responsibility (*See*, *e.g.*, Rules 54.7 and 55.5 of the Rules of the State Liquor Authority (9 NYCRR 48.7 and 49.5)).

20. Paragraphs (a), (b), and (g) of subdivision 1 of section 110 of the ABC Law require, in connection with an application for a license, that the applicant submit information which identifies with particularity the premises for which the license is sought; (in this regard, for retail licensees, no retail establishment can be within 200 feet of a school, church or synagogue (ABC Law § 105(3)), and the number of existing retail establishments in the vicinity of the applicant's premises must be identified); each person having an ownership interest in the business and premises for which the license is sought; and any person having an economic interest in the proposed licensed business or premises. The applicant is required to document the source of funds to be used in the licensed business (ABC Law § 110(1)(g)). Also required from the applicant and each partner or

principal is a ten-year history of any previous alcoholic beverage license or license application, whether in New York or any other jurisdiction (ABC Law § 110(1)(c)). A fingerprint card is required from each applicant, partner, or principal (ABC Law § 110(1)(h)). The applicant must submit documentation establishing control of the proposed licensed premises for a period not less than the license period of the license which is being sought (ABC Law § 110(1)(f)). A floor plan and photographs of the interior and exterior of the proposed licensed premises must be submitted (ABC Law § 110(1)(b)). The appropriate penal bond must be submitted in accordance with ABC Law § 112 and Rule 9 of the Rules of the State Liquor Authority (9 NYCRR 81).

21. Once a license has been issued, any premises where alcoholic beverages are manufactured or sold is subject to inspection (ABC Law § 18(4)).

22. All licensees must maintain adequate books and records and make them available for inspection by an authorized representative of the SLA (ABC Law §§ 103(7), 104(10), 105(15), and 106(12)).

23. Most violations of the ABC Law are criminal offenses. (ABC Law § 130). Police referrals to the SLA are mandated by ABC Law § 106-a(1) when police make an arrest for gambling activity, illicit drug activity, prostitution activity, weapons possession, a crime of a violent nature, or a breach of the peach which occurs on a licensed premises. Police agencies routinely advise the SLA's Enforcement Bureau of any violation of the ABC Law so that the SLA may take appropriate disciplinary action against the licensee.

24. Disciplinary penalties which may be imposed for cause by the SLA are license revocation, cancellation, or suspension; the imposition of a civil money penalty of up to $10,000 for most retail licensees, with greater civil money penalties provided for manufacturers and wholesalers (ABC Law § 17(3)); a two-year licensing ban where a license revocation has been imposed (ABC Law § 113); and a full or partial forfeiture of the penal bond filed by the licensee (ABC Law § 112) in the amount established by Rule 9 of the Rules of the State Liquor Authority (9 NYCRR 81).

25. A regulatory theme which is given effect in a number of ABC Law provisions is the legislative policy that the three tiers of the commercial alcoholic beverages business – manufacturers, wholesalers and retailers – remain independent from each other. The statutory provisions which enforce the three tier policy are intended to combat the evils of the tied house.

26. In New York, manufacturers, wholesalers, and retailers of alcoholic beverages operate under a statutory system intended to prevent tied house relationships, to preserve the economic independence of each licensee, and to establish a level playing field of even-handed competition which provides each licensee with a fair opportunity for economic success, but which avoids the public evils caused by destructive competition in the sale of alcoholic beverages.

27. Manufacturers and wholesalers are forbidden to make any gift to any person licensed under the ABC Law which may tend to influence the gift's recipient to purchase the product of such manufacturer or wholesaler (ABC Law § 101(c)).

28. Manufacturers and wholesalers are forbidden to make any loan to any person engaged in the manufacture or sale of any alcoholic beverage at wholesale or retail (ABC Law § 101(b)). Retail licensees are forbidden to make any loan to a person engaged in the manufacture or sale of liquors, wines, or beer at wholesale (ABC Law §§ 105(17), 106(14)).

29. Manufacturers and wholesalers are forbidden to enter into a contract with a retail licensee under which the retailer agrees to confine his sales to the products manufactured or sold by one or more of such manufacturers and wholesalers (ABC Law § 101(d)).

30. Manufacturers and wholesalers are forbidden to be interested directly or indirectly in any premises where alcoholic beverages are sold at retail, or in any business devoted wholly to partially to the sale of any alcoholic beverage at retail. This prohibition includes interests by way of stock ownership, interlocking directors, mortgages, liens, personal or real property, or "by any other means" (ABC Law § 101(a)).

31. Retail licensees licensed to sell liquors and/or wines for off-premises consumption are forbidden to be interested directly in any premises where liquors, wines, or beer are manufactured or sold at wholesale or any other premises where liquor or wine is sold at retail for off-premises consumption. This prohibition includes interests by way of stock ownership, interlocking directors, mortgages, liens, personal or real property, or "by any other means" (ABC Law § 105(16)).

32. Apart from a narrowly-draw exception, all licensees engaged in the retail sale of alcoholic beverages for on-premises consumption are forbidden to be

interested directly or indirectly in any premises where liquors, wines, or beer are manufactured or sold at wholesale. This prohibition includes interests by way of stock ownership, interlocking directors, mortgages, liens, personal or real property, or "by any other means" (ABC Law § 106(13)).

33. By Chapter 899 of the Laws of 1942, the Legislature added section 101-b to the ABC Law. ABC Law § 101-b(2)(a) forbids any person who sells liquors or wines to licensed wholesalers or retailers "to discriminate, directly or indirectly, in price, in discounts for time of payment or in discounts on quantity of merchandise sold, between one wholesaler and another wholesaler, or between one retailer and another retailer purchasing liquor or wine bearing the same brand or trade name and of like age and quality." One of the objectives of this provision is to prevent a commercial seller of alcoholic beverages from offering to a favored licensed commercial purchaser a special (usually secret) discount which is not made available to all like situated licensed commercial purchasers. In prohibiting a commercial seller of alcoholic beverages from discriminating between licensed commercial purchasers of the seller's product, ABC Law § 101-b(2)(a) seeks to establish a level playing field which will insure that each licensee is truly independent and not "tied" to a commercial supplier or purchaser by a special private economic arrangement which operates to the exclusion and the detriment of similarly situated licensees.

34. In simple terms, ABC Law § 101-b(3) requires that a licensed wholesaler who sells alcoholic beverages to a licensed retailer for commercial resale by the retailer must file with SLA a schedule which lists the prices at which the wholesaler will sell its products to a

retailer. The sale of product by a wholesaler to a retailer at other than the price and discounts listed in the price schedule filed by the wholesaler is prohibited. Additionally, ABC Law § 101-b (4-a) makes it unlawful for a wholesaler to refuse a sale to an appropriately licensed retailer. The requirement that a licensed wholesaler make sales in conformity with filed price schedules insures that all retailers who deal with a particular wholesaler will do so on an equal and independent footing. A wholesaler who provides special, secret discounts to favored retailers in order to exert control over them does so in violation of the statute, and jeopardizes its license. In addition to the requisite price postings that a wholesaler must file, the manufacturer-producer must file its own price schedules designating the prices at which the producer will sell its product to a wholesaler. The combined effect of the price postings of the manufacturers and wholesalers is to ensure an accountable, level playing field, free from the ill effects of a tied house.

35. In furtherance of the legislative policies expressed above and based upon the records maintained by the SLA in the regular course of business, in the last five years, the SLA has handled 21,281 matters against licensees for alleged violations of the ABC Laws (*see* SLA Annual Reports for Years 1996 (p. 31), 1997 (p. 35), 1998 (p. 35), 1999 (p. 21) and 2000 (p. 12) (*see* Ex. A). Among the matters investigated or prosecuted by the SLA over the years are the following: the keeping of alcoholic beverages for sale in bottles (1) whose contents have been contaminated with filth, (2) whose contents have been "watered", and (3) which have been refilled with different (cheaper) product; the manufacture, distribution and sale of alcoholic beverages by persons with criminal

backgrounds who are not eligible for a license; sufferance or permission by a licensee of on-premises gambling or disorders (which include altercations and assaults, drug use or sales, lewd and indecent performances or conduct, and prostitution); and the sale of alcoholic beverages to minors and visibly intoxicated persons.

36. In 1999 alone, the SLA considered 4,870 disciplinary and licensing matters, revoked 142 licenses, cancelled 241 licenses, suspended 274 licenses, issued 8 summary suspensions involving threats to the quality of community life, and imposed $7.7 million in fines. *See* 1999 SLA Annual Report at 7. In 2000, the SLA considered 3,415 disciplinary matters, revoked 93 licenses, canceled 292 licenses, suspended 186 licenses, issued 15 summary suspension orders and imposed substantial monetary fines. *See* 2000 SLA Annual Report at 13-14.

37. A November 14, 2000 printout from the agency's computer data base, generated in response to this litigation, indicates that, between January 1, 1995 and November 14, 2000, approximately sixteen thousand (16,000) administrative disciplinary proceedings were instituted base upon the alleged delivery of alcoholic beverages to persons under the legal age.[1] Under

[1] It is my understanding that plaintiffs contend that this number of administrative proceedings evidences that New York is "apparently not very effective in curtailing underage access" (Pl. Br. at 23). To the contrary, this number of disciplinary proceedings demonstrates the vigilance and effectiveness of the SLA in its ongoing and aggressive enforcement efforts to lower the incidence of underage drinking. Nor would I wish to contemplate how many more illegal sales to minors would occur (with the resulting devastating and often tragic consequences) in the absence of the vigilance of the SLA in strictly enforcing the ABC Law.

New York law, an alcoholic beverage may not be sold to any person under 21 years of age. In 1999 alone, the SLA imposed 2,437 penalties against licenses in connection with the sale of alcoholic beverages to minors. *See* 1999 SLA Annual Report at 7. Also in 1999, the SLA obtained a grant of $220,000 to establish college/community alliances to address the problem of excessive drinking by college students. *See* 1999 SLA Annual Report at 7. in 2000, for the sixth consecutive year, the most frequent violation of the ABC Law was selling alcoholic beverages to minors. In 2000, 2,025 charges were sustained. *See* 2000 SLA Annual Report at 14. Also in 2000, the SLA issued Certificates of Approval to three training programs, which are regularly providing instruction to retail licensees and their employees pursuant to the Alcohol Training Awareness Program developed by the SLA. During the first year of the program, 167 classes were conducted, with 1,611 employees completing this program. *See* 2000 SLA Annual Report at 16.

38. The type of alcoholic beverage traffic the State elects to permit within its borders is exclusively a matter of Legislative discretion. The ABC Law establishes the types of alcoholic beverage traffic the State will allow by providing for specific kinds of licenses, defining the scope of each license privilege and setting forth the restrictions and conditions which accompany each license privilege.

39. The only commercial alcoholic beverage traffic allowed in New York is that traffic expressly provided for in the various types of license privileges the Legislature defines in the ABC Law. While one might conceive of a type of commercial alcoholic beverage enterprise in

which one might desire to engage (direct shipment from an out-of-state manufacturer to a New York consumer, for example), if the Legislature has not made provision for that type of business, then such business is not allowed in New York.

40. In this regard, until 1964 the conduct of a tavern business or the operation of a cocktail lounge was not allowed in New York State. A tavern could not be operated because the ABC Law made no provision for a tavern license, and the manufacture or sale of alcoholic beverages is forbidden unless one has been issued the appropriate license. Prior to 1964, a restaurant liquor license (and variants thereof) was the only license that authorized a person to engage in the sale of liquor for consumption on the premises (ABC Law § 64). Only after enactment of ABC Law § 64-a (Laws 1964, ch. 531) has the conduct of a tavern been allowed. Thus, the establishment of a new or different license type is a matter within the scope of the Legislature's discretion. A judicial decision such as that sought by the plaintiffs here (which would, in effect, create a new license never contemplated or authorized by the State Legislature) would run afoul of the State Legislature's function.

41. For example, one may consider a person's desire to establish a business devoted exclusively to the sale of packaged beer at retail for consumption off-premises. The ABC Law currently makes no provision for the grant of such a license. In order to obtain a license to sell packaged beer at retail for consumption off-premises, a person is required to operate a grocery or drug store business (ABC Law § 54(4)).

42. As another example, a person might contemplate selling pints of liquor or wine door-to-door. Although Girl Scouts may freely go door-to-door selling cookies, the door-to-door sale of liquor or wine cannot be undertaken without a license which specifically authorizes that type of selling. No such license exists, and therefore such door-to-door sales of liquor or wine cannot be undertaken. In point of fact, the ABC Law specifically forbids any retail licensee from peddling liquor or wine door-to-door, where both the agreement-to-sell and the delivery are concurrently made at the residence or business of the consumer (ABC Law § 102(4)).

43. In the instant litigation, the plaintiffs seek to engage in a business – the direct shipment of wine from out-of-state wineries to New York consumers – which is not allowed under the ABC Law. The ABC Law does, however, provide for a winery license (ABC Law § 76). While, to my knowledge, no out-of-state winery has applied for a winery license, the language of the statute does not foreclose an out-of-state winery from doing so and obtaining such a license.[2] To be eligible for a winery license, the winery must maintain a branch office and a warehouse in New York (pursuant to a warehouse permit under ABC Law § 96); upon the submission of satisfactory applications, an out-of-state winery may be issued a winery license and warehouse permit for,

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[2] Indeed, the definition of "winery" (ABC Law § 3(37)) "includes a winery for the manufacture of wine *in any state other than New York state* and which has and maintains a *branch . . . office or storeroom within the state* of New York," thereby expressly including an out-of-state winery within the ABC Law definition. (Emphasis added).

respectively, the branch office and warehouse which the out-of-state winery maintains in New York State; the licensed out-of-state winery is authorized to receive and possess wine from *other* states consigned to its State-permitted, United States government bonded warehouse located within the State (ABC Law § 77(1)); the licensed out-of-state winery is authorized to sell from the State-permitted warehouse premises – to a licensed wholesaler or retailer, or to a corporation operating railroad cars or aircraft for consumption on such carriers – wine manufactured by the licensee *or* received by the licensee from any other state in the original sealed containers of not more than fifteen gallons each (ABC Law § 77(1)); the licensed out-of-state winery is eligible to apply for a certificate authorizing such winery to *sell wine at retail in sealed containers to a householder* for consumption in his home (ABC Law § 77(2)); and that out-of-state winery may deliver alcoholic beverages from its State-permitted warehouse to a common carrier licensed by the State to engage in the commercial transportation of alcoholic beverages, and have the licensed common carrier deliver the alcoholic beverages to a purchaser for purposes of consumption (ABC Law § 116). Alternatively, an out-of-state winery that does not desire to hold the required New York State licenses and permits available to it to be a "winery" under the ABC Law (with all of the attendant privileges) may approach New York State licensed wineries and wine wholesalers and arrange for the distribution of its product through established and State-regulated commercial channels. Another option available to an out-of-state winery is to obtain a wine wholesaler's license itself pursuant to ABC Law § 78(1).

44. If out-of-state wineries, such as the plaintiffs here, are permitted to sell and ship directly to New York consumers – without any license – the SLA will lose the ability to investigate and control such shipments, to protect against diversion of wine to unlawful purchasers (such as minors below the drinking age) and to insure that alcoholic beverages sold in this State are not adulterated.

45. Finally, it is my understanding that plaintiffs are challenging ABC Law § 102(1)(a) on the grounds that this statutory provision constitutes a blanket prohibition against an unlicensed winery sending information and advertising about its wines into the State. In particular, plaintiffs claim that ABC Law § 102(1)(a) prohibits an unlicensed winery from making its website available to persons in New York. Plaintiff's interpretation of this statutory provision is *not* that of the SLA's. Rather, the SLA has interpreted this statute to prohibit only the unlawful solicitation of orders for direct shipments of alcohol to New York residents by unlicensed producers or sellers. The SLA has never interpreted this provision as prohibiting a party such as an unlicensed out-of-state winery from advertising its products. Indeed, it is my understanding that § 102(1)(a) has been upheld as a constitutional exercise of state power in *House of York v. Ring*, 322 F.Supp. 530, 531, 533 (S.D.N.Y. 1970), where the Court held that the effect of the statute was to prevent a mail order wine and liquor solicitation service "from sending its *solicitations or order forms* into the State of New York unless it is licensed."

/s/ Thomas G. McKeon
Thomas G. McKeon

Sworn to before me
this 17 day of August, 2001

/s/ Joyce A. Rosario
Notary Public
JOYCE A. ROSARIO
Notary Public, State of New York
No. 01RO46301.50
Qualified in Kings County
Commission Expires Jan. 31, 2002

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

DECLARATION OF FREDERICK P. SCHAFFER IN SUPPORT OF DEFENDANTS' CROSS MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

Dated August 17, 2001

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1. I am the Vice Chancellor for Legal Affairs and the General Counsel to the Board of Trustees of the City University of New York. I make this declaration, based on my personal knowledge and review of the attached exhibits, in support of defendants' cross-motion for summary judgment and in opposition to plaintiffs' motion for summary judgment.

2. I submit this declaration on behalf of the City University of New York, the State University of New York, Fordham University, and St. Francis College (collectively, the "*amici*") – all New York State universities and colleges that support this State's ban on direct shipment of alcoholic beverages from out-of-state suppliers to New York consumers. The *amici* agree that abstinence is the appropriate choice for certain segments of the population, particularly for those under the legal minimum drinking age of 21; that the sale and distribution of alcoholic beverages should be strictly controlled, as the New York State Liquor Authority has historically done in this State; and that evisceration of current State laws that prohibit and

prevent out-of-state direct shipping to New York consumers will necessarily lead to increased underage drinking.

3. The *amici* include more than 90 schools attended by more than 550,000 students, many, if not most, of whom are under the legal drinking age of 21, have some level of computer and Internet skills, and can gain access to credit cards.

4. From the *amici*'s perspective, the prospect of direct shipment of alcoholic beverages, whether it be through the Internet, mail-order, or 800-numbers, raises several significant concerns. In general, it would permit drinkers easier access to alcoholic beverages and, thus, facilitate more underage drinking. Moreover, increased alcohol use would cause both immediate and long-term harms.

5. Specifically, the availability of ordering alcoholic beverages over the Internet increases the risk of underage drinking on college campuses. As the organization, Americans for Responsible Alcohol Access ("ARAA"), has stated:

> With direct shipping, teens don't have to worry about risks associated with purchasing from local outlets. No longer do they have to forge fake ID's and chance getting caught and arrested for buying alcohol at a store monitored by the police. All they have to do is dial a toll-free number or log on the Internet and mouse-click "Yes" to the question of whether they are of age. They can pay by credit card or even the new checking account debit cards which function much the same as a credit card. Indeed, most students go off to college these days with a credit card, yet most are not of legal drinking age until their junior year. Delivery truck drivers are not in the

> business of checking ID's – and in any case many direct shippers don't label their packages or intentionally list contents deceptively, such as "olive oil."

Fact Sheet: Underage Access Resulting From Direct Shipping of Alcoholic Beverages, (Americans for Responsible Alcohol Access), at 1-2 <http://www.araa.org> (visited July 27, 2001) (hereinafter "*Fact Sheet*") (a true and correct copy of a printout from which is attached hereto as Exhibit 1).

6. Alcohol abuse poses a serious threat to the health and welfare of affected college students and to the safety of college campuses. That is why, each year, many colleges and universities throughout New York State, including some of the *amici* here, devote resources to education, intervention and prevention efforts relating to alcohol abuse. Unlimited and unregulated access to alcohol through the Internet, mail-order or 800-numbers will only exacerbate the challenges faced by our State's colleges and universities in their attempts to address the health and safety problems caused by alcohol abuse.

7. The *amici* seek to bring to the Court's attention the social and public health consequences that will likely result if the Court strikes down New York's "three-tier" system, thereby permitting the direct sale and shipment of alcoholic beverages from unlicensed out-of-state producers to New York consumers. The expanding use of the Internet has given unlicensed out-of-state producers and sellers of wine, beer and hard liquor an opportunity never before possible to circumvent New York's alcoholic beverage control laws.

8. Unlike out-of-state producers and sellers of alcoholic beverages who are beyond the jurisdiction of New York State regulations, in-state entities licensed by the State Liquor Authority to traffic in alcoholic beverages face civil and criminal sanctions if they fail to comply with New York's alcoholic beverage control laws, including monetary penalties and license suspension or revocation.

9. Moreover, although this case purports to address only wine, the relief that plaintiffs seek would result in the abrogation of New York's entire "three-tier" system of alcoholic beverage distribution. Thus, should plaintiffs prevail, beer and hard liquor, in addition to wine, would also be able to be shipped directly to New York consumers. Accordingly, any analysis of the potential harms that will occur from direct shipments by unlicensed sources should take into account all alcoholic beverages, not just wine.

10. If the requirement that all out-of-state alcoholic beverages be imported through in-state licensed wholesalers were to be struck down, the practical means of enforcing the regulations would be lost, and any unlicensed out-of-state producers or sellers of alcoholic beverages would be able to sell to minors with impunity. Indeed, these out-of-state sellers could not be held legally accountable for making beer, wine and hard liquor readily available to minors, whose use of the Internet and other means would permit them to circumvent the legal restrictions applicable to them.

11. Under New York law, licensees are liable for the sale of alcoholic beverages to minors. Accountability is essential. It is already difficult enough to enforce the minimum legal drinking age. The current direct shipping ban, however, draws a bright line, over which responsible

parties and common carriers will not cross. Thus, eviscerating the direct shipping ban will blur that bright line and, thus, exacerbate the problem of underage drinking and other social ills.

Underage Alcohol Use And Abuse

12. Recent studies have noted disturbing levels of underage alcohol use and abuse. According to those studies, 54% of 8th graders, 72% of 10th graders, and 82% of 12th graders report having consumed alcohol. *See* Patrick M. O'Malley, et al., *Alcohol Use Among Adolescents*, 22 ALCOHOL HEALTH & RES. WORLD 85, 86 (1998) (a true and correct copy of which is attached hereto as Exhibit 2). The conclusions are grim: "[A]lcohol use and abuse, as well as alcohol-related problems, continue to be highly prevalent among American youth and a major source for concern. In fact, excessive alcohol use and its associated problems appear to have increased in recent years, following an earlier period during which both the rates of heavy drinking and the incidence of driving after drinking declined." *Id.* at 91.

13. These troublesome patterns continue, and grow worse, as young people move from adolescence into early adulthood, from high school into college. Indeed, according to a national study, young adults aged 18 to 20 had the second highest prevalence of heavy drinking among all age groups and the highest rate of alcohol dependence among all age groups. *See* Summary of Findings from the 1999 National Household Survey on Drug Abuse, (Department of Health and Human Services, Substance Abuse and Mental Health Services Administration) (1999) (a true and correct copy of which is attached hereto as Exhibit 3).

Drinking On College Campuses

14. Although most college students are underage, "alcohol remains widely available – and highly promoted – to students of all ages." Adam Cohen and Greg Fulton, *Battle of the Binge*, TIME, September 8, 1997, at 1 (a true and correct copy of which is attached hereto as Exhibit 4). In fact, "from the moment freshmen set foot on campus, they are steeped in a culture that encourages them to drink, and drink heavily." *Id.* at 2.

15. According to statistics compiled by Mothers Against Drunk Driving ("MADD"), college students spend $5.5 billion on alcohol each year, more than they spend on soft drinks, tea, milk, juice, coffee, or school books combined. *See Underage Drinking Information Parents Need to Know, College Statistics*, (Mothers Against Drunk Driving), at 2. <http://www.madd.org/under21/youth_issues.shtml> (visited July 27, 2001) (a true and correct copy of a printout from which is attached hereto as Exhibit 5). MADD makes a "conservative" estimate that American college students drink over 430 million gallons of alcohol a year – the equivalent of 3,500 Olympic size swimming pools. *Id.*

16. College and university administrators face significant obstacles in attempting to prevent alcohol abuse on their campuses. College students have considerable autonomy. Underage students are surrounded by other students who are over 21 and may be willing to help them get alcohol. Various media, including films and music, reinforce the idea that excessive drinking is a rite of passage for college students. Thus, school administrators, who care deeply about the health and well-being of

their students, need all the help that our laws can give them in attempting to meet these challenges.

Marketing Of Alcoholic Beverages To Minors

17. Studies show that, despite voluntary industry code provisions that prohibit it, the Internet is used extensively to market alcohol and the culture of alcohol use to young people, including adolescents. These sophisticated marketing tactics contribute to minors' attitudes, values and preferences in making decisions about alcohol.

18. One of the first studies to explore the Internet marketing of alcohol and tobacco to minors was done by the Center for Media Education (CME) and reported in March 1997. *See Alcohol and Tobacco on the Web: New Threats to the Youth, Executive Summary*, (Center For Media Education), March 1997, at 1, <http://www.cme.org/children/marketing/execsum.html> (visited July 27, 2001) (a true and correct copy of which is attached hereto as Exhibit 6). That study found that:

> [A]lcohol and tobacco companies are using the online media to advertise and promote their products, through a variety of marketing techniques that capitalize on the medium's strong and unique attraction for young people.
>
> These campaigns are being launched at a time when drinking and smoking among youth are at alarmingly high levels. Underage drinking and smoking are already a major public health problem in the U.S. Alcohol is a factor in all leading causes of death for young people ages 15 to 24.

Id. at 1. That study also found that many websites marketing alcohol "are designed to take advantage of the

unique properties of the interactive online media. Many of these techniques are particularly appealing to children and youth." *Id.*

19. In December 1998, CME published an update to its original study. *See Alcohol Advertising Targeted at Youth on the Internet: An Update*, Center For Media Education, December 1998 <http://www.cmc.org/publications/alcohol_tobacco/alcrep.html> (visited July 27, 2001) (a true and correct copy of which is attached hereto as Exhibit 7). The update examined a total of 77 beer, wine and spirits websites. *Id.* at 1. It identified elements that were considered to appeal to youth and found that 62% of the sites included at least one such element, with the typical site having at least three such elements. *Id.* at 2. The study noted:

> Individually, some of these techniques do not necessarily indicate an appeal to youth. However, when used in combination – as they usually are – children can be kept at a site for hours and persuaded to return time and again. It is in this way that companies are able to build a long-term relationship with young people. The sites that appear to appeal to youth often strive to create a community of brand-loyal enthusiasts, a place where lonely teens can talk, find peers and support for risky activities like binge drinking. Known among marketers as "relational" advertising, this effort to build a relationship between the user and the product is the dominant trend in marketing on the Web and is already heavily exploited by the alcohol industry.

Id. at 2-3.

20. Overall alcohol consumption in the U.S. peaked in the early 1980s, then began a steep decline, particularly among distilled spirits. Indeed, between 1987 and 1997, average annual consumer expenditures on alcoholic beverages dropped 24 percent. U.S. Wine Demographic Report, MKF Research Group at 7 (2000) (a true and correct copy of which is attached hereto as Exhibit 8). Nevertheless, in contrast to other alcoholic beverages, wine volume grew 30 percent over the past two decades. *Id.* at 9. Moreover, as the MKF Research Group recently reported, "some experts believe that this overall decline [in alcohol sales] is reaching an end and that an increase in the number of drinking-age youths is just around the corner as the children of Baby Boomers come of age, creating a 'baby boom echo.'" *Id.* at 7.

21. As opposed to distilled spirits, wine consumption was buttressed, even during this period of declining overall alcohol sales in the 1980s, by the emergence of non-traditional wine-based products generally classified as "wine coolers." During the decade of the 1980s, "wine coolers" were particularly popular with women, including underage girls. These sweet-tasting, low-alcohol drinks made from fruit juice and low-quality wine came on the market almost by accident. *See Wine*, 18 BOTTOM LINE ON ALCOHOL SOC'Y 105, 105-111 (1997) (a true and correct copy of which is attached hereto as Exhibit 9).

22. Considering the entry-level market for alcoholic beverages, low-alcohol, sweet-tasting drinks are a natural bridge for young people from soft drinks. Hoppers Hooch, Two Dogs Lemonade and similar malt-based products offer vintners an ability to appeal to the underage market, as "wine coolers" have. These drinks could easily be marketed to underage teens through the Internet. *See California*

becomes the battleground for Alcopops – TGIF, Hooper's Hooch and more . . ., 17 BOTTOM LINE ON ALCOHOL SOC'Y 40, 40-46 (1996) (a true and correct copy of which is attached hereto as Exhibit 10).

23. Many of the Internet wine sites contain links to "favorite sites" that take the reader directly to youth-oriented wine sites. An example is an electronic magazine, *Wine X Wired*, with features such as "Sex, Wine & Rock n Roll." *See* Wine X Wired, <http://www.winexwired.com/toc.htm> at 4 (visited July 27, 2001) (a true and correct copy of a printout from which is attached herein as Exhibit 11). In content and format this website is an appeal to youths.

24. Moreover, studies show that most youths who drink do not limit themselves to one beverage but, rather, tend to consume beer, wine and spirits. *See* Stephen Hansell, et al., *Specific Alcoholic Beverages and Physical and Mental Health Among Adolescents*, 60 J. STUD. ALCOHOL 209, 209-217 (1999) (a true and correct copy of which is attached hereto as Exhibit 12).

25. Nor does there seem to be any practical means to shield youths from this concentrated Internet appeal. An October 1999 CME study focused on the ability of filtering and rating technologies to screen promotional alcohol and tobacco content and found them to be extremely ineffective. *See Youth Access to Alcohol and Tobacco Web Marketing, The Filtering and Rating Debate*, (Center For Media Education), October 1999, <http://www.cme.org./publications/reports/html> (visited on July 27, 2001) (a true and correct copy of which is attached hereto as Exhibit 13).

26. Among the classes of alcoholic beverages, wine has taken leadership from distilled spirits and malt beverages on the Internet as the only advertiser among the top 100 in Dot-com ad spending, according to a leading advertising trade publication. *See Advertising Age*, at 26 (September 25, 2000) (a true and correct copy of which is attached hereto as Exhibit 14). For example, *Wine.com* increased its offline media advertising to call attention to its products available online from $392,800 in the January-June 1999 period, to $5,090,900 for the July-December 1999 period, to $6,640,700 for the first six months of 2000. *Id.*

27. Internet marketing to youth, if coupled with direct shipments of alcohol from unlicensed out-of-state suppliers, could have devastating consequences because of the practical problems in preventing such sales to minors. The December 1998 CME update study addressed the inadequacy of age verification in alcoholic beverage Internet sites and found:

> Forty-four percent (44%) of the analyzed Web sites made some kind of statement regarding the required age to enter the site. Most of the time these proved to be ineffective barriers, as one need only be able to subtract 21 from the current year to bypass the requirement. Or, more commonly an underage visitor might put in her real age, be blocked from entering the site, only to hit the "back" button, do the math and then enter successfully.

Exhibit 7 at 6.

28. One recent study, while not dealing specifically with Internet sales, examined the greater availability of alcohol to underage drinkers. *See* Linda A. Fletcher, et. al.,

Alcohol Home Delivery Services: A Source of Alcohol for Underage Drinkers, 61 J. STUD. ALCOHOL 81, 81-84 (2000) (a true and correct copy of which is attached hereto as Exhibit 15). That study included surveys of high school seniors and persons age 18-20.

29. The authors of that study noted the reason why remote purchases of alcohol are particularly attractive to young people:

> Alcohol home delivery services are a unique form of alcohol availability in that the sale occurs privately, away from commercial outlets, making it less likely to be observed by other customers, outlet management surveillance cameras or enforcement agents . . . Young people may feel more comfortable attempting to buy alcohol in unmonitored home-delivery settings, believing they are less likely to be caught making an illegal alcohol purchase. Young people's perceptions about the level of risk involved in obtaining alcohol may affect their use of certain sources for alcohol.
>
> * * *
>
> An unexpected finding was that 12th graders were significantly more likely than 18- to 20-year-olds to have purchased delivered alcohol, possibly because older drinkers may be able to more easily make direct alcohol purchases at an outlet.

Id. at 81, 83.

30. The authors of that study concluded that home delivery is one of a number of sources of alcohol for underage drinkers:

> Knowledge of the sources of alcohol to underage drinkers is an important step in developing policies that help reduce youth alcohol access and resulting injuries, violence and social problems. Placing restrictions on or more closely monitoring home deliveries of alcohol may be part of a larger set of policies that need to be implemented. Policy measures that target alcohol sales via delivery may particularly affect younger drinkers and those at risk for alcohol-related problems.

Id. at 84.

31. While discussion there centered around home delivery resulting in easier access for underage drinkers, a related study showed the impact of these sales on another segment of the "at risk" population: severe alcoholics or problem drinkers unable to get alcohol by conventional means. This study concluded that the easier access provided by home delivery is similar to the easier access offered by online purchasing. *See* Alexander Wagenaar, *Home Delivery of alcohol to youth and problem drinkers*, 19 BOTTOM LINE ON ALCOHOL SOC'Y 33, 33-48 (1998) (a true and correct copy of which is attached hereto as Exhibit 16).

32. Researchers examined the experience of patients who were participating in a specialized treatment program for severely medically ill alcohol dependent patients. The Alcohol Related Disorders clinic at the Minneapolis VA Medical Center involved family and community resources whenever possible to manage behavior of those suffering from serious medical complications from drinking such as alcoholic cirrhosis, alcoholic hepatitis, upper gastropomtestoma, bleeding and alcoholic cardiomyopathy. *Id.* at 38-41.

33. The treatment program involved efforts to cut off or reduce the patient's access to alcohol. The researchers concluded:

> Such efforts are sometimes hampered when patients, especially those who are too sick or debilitated to get alcohol in more conventional ways, resort to alcohol home delivery services to obtain alcohol. Through home delivery these patients are able to continue drinking and risk worsening already life-threatening medical problems despite the efforts of family and clinical staff.

Id. at 39.

34. In New York, the policy measures mentioned in the Fletcher study are reflected in the licensing and regulations that are part of New York's "three-tier" system. *See* Exhibit 15. They will be largely undone if the plaintiffs' requested relief is granted in this case. Unlicensed out-of-state sellers are not accountable to the State Liquor Authority, and their sales activities may even go undetected. Without the accountability mechanism of licensing, which includes the ability to demand compliance by the threat of license suspension or revocation or substantial monetary penalties, these controls will be virtually unenforceable against out-of-state sellers. The result will be an open pipeline to every college dorm room with an Internet connection and to every adolescent drinker with computer and credit card access.

The Adverse Effects Of Greater Access For Youth To Alcoholic Beverages

35. At hearings on interstate alcohol sales before the U.S. Senate Judiciary Committee on March 9, 2000,

witnesses testified that "[o]ne of the strongest -- and most universally accepted – justifications for controlling the sale of alcohol is to prevent consumption by minors." *Interstate Alcohol Sale and the Twenty-First Amendment: Hearings on H.R. 1063 Before the Senate Judiciary Committee*, 106th Cong. J-106-7, at 28 (1999) (Statement of Wayne Klein, Assistant Attorney General, State of Utah). To paraphrase the statement of one law enforcement official:

> Direct shipments of alcohol, whether purchased by internet, mail order or telephone, make it significantly easier for underage drinkers to obtain alcohol by eliminating the face-to-face contact between buyer and seller which facilitates age and identity determinations. As noted above, internet order forms may inquire about age, but there is no verification;
>
> Age verification at the time of delivery is ineffective because direct shippers often fail to identify the seller on the package or that the package contains alcohol, and do not state that an adult signature is required for delivery;
>
> A criminal investigation of a beer seller revealed that of 558 cases of alcohol delivered to Utah residents by the seller during a three-month period, 330 simply were left at the delivery site without any human recipient, much less the signature of an adult.

Id. at 28-29; *see also id.* (Statement of Senator Orrin Hatch (R-Ut.) at 1-3; Statement of Congresswoman Juanita Millender-McDonald (D-Ca.) at 9-12; and Statement of Congressman Robert L. Ehrlick, Jr. (R-Md.) at 7-9) (true and correct copies of which are attached hereto as Exhibit 17).

36. The impact of permitting direct sales by unlicensed sellers or producers is illustrated in a survey of college students. That survey revealed that:

- 68% (598,400 students nationally) of currently enrolled college students report that they drink beer, wine and/or liquor;
- 62% of college freshmen report drinking beer, wine and/or liquor;
- 59% of college students under age 21 report drinking beer, wine and/or liquor; and
- 80% of all students say their peers are likely to purchase alcohol on-line if age verification is not enforced.

See Memorandum from Mike Dabadie of Wirthlin Worldwide to Americans for Responsible Alcohol Access, at 1-2 (March 27, 2000) (a true and correct copy of which is attached hereto as Exhibit 18). Asked whether they would be likely to purchase alcohol over the Internet if no age verification were enforced, 35% of all students under age 21, 39% of freshmen, and 47% of male students under age 21 responded that they would likely make alcohol purchases under these circumstances. *Id.*

37. In that same survey, 17% of college students responded that they are aware of on-line purchasing, 2% have actually purchased over the Internet, and 5% know someone who has purchased over the Internet. *Id.* at 3. In terms of Internet access generally, 99% of college students report having access to the Internet. *Id.* at 1. Moreover, forty-six percent (46%) of Internet-connected households have children under age 18 at home. *Id.*

38. As that survey confirmed, the Internet represents a significant untapped market for alcohol sellers, including wineries. Thus, faced with increased enforcement efforts at retail locations, underage drinkers are likely to turn to the Internet, mail order or toll free calling for their alcohol purchases. *Id.* at 3.

39. Permitting direct interstate sales to New York consumers by out-of-state wineries will result in alcohol being more readily available to underage drinkers and increased levels of consumption. Studies correlate higher availability of alcohol with higher rates of consumption. *See* Alexander C. Wagenaar, *Minimum Drinking Age and Alcohol Availability to Youth: Issues and Research Needs,* in 25 ECON. & PREVENTION ALCOHOL-RELATED PROBS., 175, 176-94 (Hilton and Bloss eds. 1993) (a true and correct copy of which is attached hereto as Exhibit 19); Traci Toomey et. al., *Policy-Alcohol*, 3 ANN. REV. ADDICTION RES. TREATMENT 279, 281 (1993) (a true and correct copy of which is attached hereto as Exhibit 20); Paul J. Gruenwald, et. al., *The Relationship of Outlet Densities to Alcohol Consumption: A Time Series Cross-sectional Analysis*, 17 ALCOHOLISM CLINICAL EXPERIMENTAL RES. 38, 38-47 (1993) (a true and correct copy of which is attached hereto as Exhibit 21).

40. Also of note, if out-of-state suppliers are able to bypass New York taxes, the resulting lowered price will tend to increase the level of consumption by minors. Studies correlate higher cost with lower consumption of alcohol, particularly among minors, just as higher cost discourages use of tobacco products, especially by minors. *See* Exhibit 20 at 280-81.

41. The National Highway Traffic Safety Administration has estimated that between 1975 and 1995, 15,667 lives were saved by raising the Minimum Legal Drinking Age (MLDA) from 18 to 21. *See Youth access to alcohol continues as public policy issue with renewal of the debate on minimum drinking age laws*, 19 BOTTOM LINE ON ALCOHOL SOC'Y 137, 141 (1998) (a true and correct copy of which is attached hereto as Exhibit 22).

42. In addition, researchers found that the problems of suicides, hospital admissions, pedestrian accidents and vandalism decreased as a result of reduced underage drinking after the MLDA was raised from 18 to 21. *Id.* at 141-42.

43. Nevertheless, alcohol-related problems have persisted among youth since the change in the MLDA. *See* LLOYD D. JOHNSTON, ET. AL., U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES, SMOKING, DRINKING, AND ILLICIT DRUG USE AMONG AMERICAN SECONDARY SCHOOL STUDENTS, COLLEGE STUDENTS, AND YOUNG ADULTS, 1975-1991, at 15, 18, 19 (1992) (a true and correct copy of which is attached hereto as Exhibit 23).

44. According to the most comprehensive examination of drinking problems among young people yet on record, the National Institute on Alcohol Abuse and Alcoholism (NIAAA) concluded that the younger the age of drinking onset, the greater the chance that an individual at some point in life will develop a clinically defined alcohol disorder, which was defined as either alcohol abuse or alcoholism. *See* Bridget F. Grant, *Age At Smoking Onset And Its Association With Alcohol Consumption And DSM-IV Alcohol Abuse And Dependence: Results From The National Longitudinal Alcohol Epidemiologic Survey*, 10 J.

SUBSTANCE ABUSE 60 (1998) (a true and correct copy of which is attached hereto as Exhibit 24).

45. That study concluded that young people who began drinking before the age of 15 were four times more likely to become alcoholics than those who began drinking at the legal age of 21. *See The Legal Drinking Age*, Monday Morning Report (Alcohol Research Information Service, Lansing, Michigan), February 16, 1998, at 2 (a true and correct copy of which is attached hereto as Exhibit 25). Moreover, researchers found that a person who began drinking before age 15 was twice as likely to experience alcohol abuse problems than someone who began drinking at 21. *Id.* NIAAA researchers defined alcohol abuse as "a maladaptive drinking pattern that repeatedly caused life problems." *Id.*

46. The consequences of alcohol abuse by young drinkers are serious and too often fatal. Alcohol has been identified as a major factor in accidents, homicides, and suicides, which are the three leading causes of death among 15- to 24-year-olds. *See* 1995 Report of the Center for Disease Control, as cited in *Facts: Underage Drinking* (a true and correct copy of which is attached hereto as Exhibit 26).

47. Researchers have also found that people who began drinking while underage are much more likely to get hurt in car crashes or suffer injuries in a wide variety of alcohol-related accidents, while walking, swimming, boating or engaging in other activities of daily living, particularly when under the influence of alcohol. *See* Ralph W. Higginson, et. al., *Age of Drinking Onset and Unintentional Injury Involvement After Drinking*, 284 Journal of the American Medical Association 1527, 1527-1533 (2000) (a

true and correct copy of which is attached hereto as Exhibit 27).

The Threat To Our State's College Students From Internet Access To Alcohol In The Absence Of A Direct Shipping Ban

48. Internet sites that facilitate the sale and direct shipment of alcohol products will only aggravate this country's underage drinking problem. As witnesses testified before the Senate Judiciary Committee, "the access to alcohol by underage drinkers increases once they arrive on college campuses, where the Internet serves as a stronger role in their education." *See* Exhibit 17 at 11 (Statement of Hon. Juanita Millender-McDonald). As previously noted, some of the *amici* have undertaken efforts to educate their students about the dangers of excessive drinking, and Internet sites that do not check the age of the purchaser or limit the amount that can be purchased can only undermine these ongoing efforts. *See e.g.*, <http://www.internetwines.com> (visited July 27, 2001) (showing that for eighteen dollars one can order a bottle of 192 proof grain alcohol) (a true and correct copy of a printout from which is attached hereto as Exhibit 28).

49. College students are among the most prolific and sophisticated users of the Internet. A study conducted by Rensselaer Polytechnic Institute concluded that 28% of all Internet users are full-time college students. *See* Keith J. Anderson, *Internet Use Among College Students: An Exploratory Study*, at 2, <http://www.rensselaer.edu~anderk4/research.html> (visited July 27, 2001) (a true and correct copy of a printout from which is attached hereto as Exhibit 29). This figure reflects the high percentage of colleges and universities that have an Internet presence,

that provide Internet access free of charge, and that have Internet connections in residence hall rooms or available on campus 24 hours per day. *Id.*

50. Today's cyber-savvy underage college students can easily order alcohol over the Internet and have it delivered to their homes or college dormitories. As previously explained, "[a]ll they have to do is . . . log on the Internet and mouse-click 'Yes' to the question of whether they are of age." Exhibit 1 at 2 (*Fact Sheet*).

51. That underage college students will avail themselves of this opportunity is a certainty. In a survey released in May 2000, nearly 18,000 college students said that they had already purchased alcohol on the Internet or from catalog or toll-free phone services, and, "an astonishing 89 percent of freshmen said that their peers would be likely to purchase alcohol over the Internet if no age verification were required, especially since most college students are not of legal age (21) until their junior or senior year." *See Eighty Percent of College Students Say Peers Likely to Purchase Alcohol Online*, 17 BEER PERSP. (Nat'l Beer Wholesalers Assoc.), May 8, 2000, at 2, <http://www.nbwa.org/inex2.html> (visited July 27, 2001) (a true and correct copy of a printout from which is attached hereto as Exhibit 30).

52. To promote temperance and prevent alcoholic beverages from reaching minors, the State must be permitted to continue to control alcohol distribution and to have the authority to limit it to licensed sellers who can be held accountable if they do not strictly comply with New York's alcohol beverage control laws. This Court should therefore uphold New York's "three-tier" system, which insures that those who sell alcohol to New Yorkers are

in-state licensed parties subject to State sanctions if they sell alcohol to minors.

I declare under penalty of perjury that the foregoing is true and correct. Executed on August 14, 2001.

/s/ Frederick P. Schaffer
Frederick P. Schaffer

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Exhibit 16 to Declaration of Clint Bolick, executed on October 11, 2001, in support of Plaintiffs' Reply Memorandum in Support of Motion for Summary Judgment, dated October 17, 2001 – Affidavit of Simon Siegl, sworn to on September 26, 2001

AFFIDAVIT OF SIMON SIEGL IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' AND INTERVENOR DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

CITY OF WASHINGTON)
) SS.
DISTRICT OF COLUMBIA)

Simon Siegl, being duly sworn, deposes and says:

1. I am an adult resident of Virginia. Since July of 1996 I have served as president of the American Vintners Association (AVA), a national trade association representing 680 winery members in 44 states. From 1985 to 1996, I served as executive director of the Washington Wine Institute, a trade association of wineries in that state.

2. I have reviewed the various submissions of the Defendants and Intervenors, including their brief, statement of facts, and affidavits. Those documents

contain numerous material factual errors and mischaracterizations that are addressed in this affidavit.

3. The issue of direct shipments from wineries to consumers has been a top priority during the sixteen years I have represented wineries through trade association management. It is through this direct experience that I supply the following information.

Introduction

4. The three-tier system is an efficient mechanism that serves the supplier, wholesaler and retail marketplace for distribution of wines supplied by domestic and imported brands that have the production capacity and other resources necessary to support the wholesaler tier as currently structured. It best serves – and its primary customers are – a small number of large volume, well-known brands. Since the inception of the three-tier system, however, the American wine industry and the interested wine consuming public have both changed dramatically.

5. Records of the Bureau of Alcohol Tobacco and Firearms, which licenses commercial wineries, show that there were 579 American wineries in 1975 and 2,188 for the year 2000, a growth of 278%. The three-tier system has not only been unable to service this growth in the supplier tier during this period, but has simultaneously experienced a dramatic consolidation of major wine wholesalers, resulting in a reduction of distribution channels available to wineries.

6. For most small wineries, with limited quantities of wine for sale, it is a daunting and near impossible task to obtain wholesaler interest in representation of their wines outside of their primary market. Even when they succeed in gaining representation, the costs imposed by an impractical system designed for a

different type of marketing make such representation futile. Meeting the needs and marketplace opportunities for both the supplier and consumer groups is the reason that AVA seeks to augment the three-tier system with additional market access.

Marketing by American Wineries

7. While about 50 wineries in the United States produce 90 percent of American wine, most wine producers are small, family run businesses that serve a relatively local market. There are now over 2,000 wineries located in forty-nine of the fifty states. Over 80% of wineries are truly cottage businesses which produce less than 25,000 cases per year, a quantity which could reasonably be marketed through their tasting rooms and a supplemental list of interested customers. Wineries with such small quantities are rarely of interest to large, broad-based distribution companies. These family wineries produce less than 3% of the total wine marketed in this country.

8. It is an important characteristic of the American wine market that a large percentage of purchasers seek distinctive, individualistic products representing differentiated growing and producing factors, rather than blended and fungible commodity type wines. This interest in distinctiveness is exemplified, in part, by the fact that *The Wine Spectator*, the largest circulation consumer-oriented publication, carefully reviews over 10,000 wines per year.

9. The American wine market comprises a wide range of products and price points. For instance, Cabernet Sauvignon, a common red wine variety, can sell for less than $2.00 per bottle (750 ml equivalent) to over $100 per bottle. It is that very diversity of products, produced in so many regions of the country, and with

so many marketing niches, which necessitates alternative mechanisms of marketing to ensure that American wineries are not handcuffed in how they may produce their products and forced into an indistinct conformity. For a variety of reasons, wine consumers often become loyal to particular wine offerings and wish to continue their relationship by purchasing those wines and sharing them with friends. In many ways a bottle of wine is a socially important "conversation piece".

10. A family winery ordinarily will use three-tier distribution for its wine in the state in which it is located and perhaps a couple of neighboring states where strong interest in the wine can be developed. But it is extremely rare for otherwise viable small wineries to have national distribution networks because they simply do not produce enough product to supply the needs of those wholesalers and because the cost of supporting the wholesaler is prohibitive.

11. Tourism is a driving force for most of the smaller wineries, which almost universally have on-site retail operations for their visitors. Through these tasting rooms a wide and diverse population is exposed to the products of craft wineries. Many visitors seek to continue that relationship even though they may reside in other states. Similarly, because America is made up of a very mobile population, many customers who have discovered and developed relationships with particular wineries while living in one state want to continue purchasing those wines after moving to another state.

12. Besides California, there are wineries without national distribution in North Carolina, Georgia, Missouri, Texas, Washington, Virginia and Oregon -- as well as New York – that are major tourist attractions and welcome from 50,000 to 700,000 visitors per year,

from almost all states. Yet none of these wineries have their wines in distribution in more than a handful of states. Because of restrictive laws in many states, including New York, it is impossible for wineries to fulfill the majority of orders from most out-of-state customers. In addition to the negative public relations implications, these lost sales opportunities diminish winery revenues and their ability to maximize potential growth.

The Nature of Selling Wine in the United States

13. Outside of the products of the 50 or 100 largest wineries, most wine is "hand sold." Advertising or mass brand identification is unheard of. Instead, such wine is sold through the knowledge and recommendation of members of the wine trade in direct, one-to-one contact with the person who is going to purchase and consume that wine. This fact points out, in a dramatic way, the limited influence of wholesalers on the marketing of wine. Their sales force never comes directly in contact with the ultimate customer. At best they help fulfill a sale made by a winery, a retailer or a restaurateur to a customer. In many cases the wholesaler actually impedes the sale by adding a layer of bureaucracy to the process of making this sale.

14. In most cases it is the winery that must impart the information and enthusiasm for a particular wine product to the customer either directly or by visiting retail stores and restaurants. That is why virtually all wineries employ a sales force that must make regular contact with their key retail stores and restaurants. For family wineries, that sales role is often the responsibility of the winery owner or winemaker.

Costs of supporting a wholesaler

15. A key element in any winery's decision to utilize a wholesaler is the cost of supporting that wholesaler. This is not primarily related to the approximately 30% typical markup that a wholesaler takes for its gross profit, even when it is doing little or nothing to produce sales. For a bottle of wine that sells for $20 at retail, the wholesaler takes about $3.00. Retailers receive about $6.50. The winery retains under $10 after transport and taxes are deducted. The critical factor in determination of whether to use a wholesaler is the cost of establishing and maintaining that channel.

16. As described above, in order to generate sales in New York, a winery owner or key employee has to make at least one trip a year into the New York marketplace to educate and motivate retail and restaurant personnel about the winery's products. This is expensive. To support sales of one hundred cases of wine in New York that trip might involve costs of $2,000 in time and about $3,000 in travel and entertainment expenses. These costs amount to over $4.00 per bottle, assuming the goal of selling 100 cases is achieved. Often one must invest that much money only to see sales of 20 to 50 cases.

17. The hard fact is that these support costs so erode any possible margin for a small winery that it can be a poor business decision to market to New York customers through the three tier system. By contrast, selling those 100 cases as 1,200 bottles to 1,200 loyal New York customers through direct marketing can probably be achieved at a cost of less than $1.00 per bottle, netting a winery $19 per bottle rather than $6.

"Push" versus "Pull" Marketing

18. Typical marketing and sales efforts by the supplier "push wine through the conventional three-tier system building inventory at both wholesalers and retailers while waiting for the consumer to purchase the product. After sufficient sales are made the wholesaler reorders from the winery to maintain inventory. Wineries have a unique capacity, however, to develop "pull" sales through direct contact with customers. Tourist visitors, wine club members, preferred customer groups, national media exposures, and other opportunities create the pool of qualified customers who know what product they want and can initiate the purchase directly from the winery. Advantages of pull marketing include a much more limited need for dispersed inventory development and much better alignment of product with actual sales.

19. AVA originated a "pull" marketing concept in 1992 to allow wineries to make the ultimate sale before the process of inventorying and transportation began. Consumer orders received and paid for would be fulfilled in full compliance with the three tier system by having the wine properly labeled and shipped through a wholesaler and retailer to the ultimate purchaser. AVA's concept was developed and then spun off in 1994 as an independent commercial enterprise known as Cellermasters of America. Cellermasters was designed to accommodate special orders from consumers in any location to all cooperating wineries. Cellermasters was purchased by Wineshopper.com in 1999.

20. Technical problems plagued the implementation of this plan from the beginning. State legislative and regulatory impediments like wholesaler "franchise" laws (which prohibit wineries from free movement between competing wholesalers), at rest laws (requiring shipments to be held at wholesaler warehouses for

one to three days), label approval requirements, price listing requirements and a general lack of motivation of wholesalers to handle special orders led to the demise of this approach in 2001.

21. In spite of wholesalers constantly citing to state legislatures that customers could order and receive any wine they want, virtually so wine was ever shipped and delivered within the constraint of the special order system developed as part of Cellermasters, "800" number services, Wineshopper.com or other wholesaler designed pull-marketing systems. Over the years considerable investments were made in these mechanisms, especially Wineshopper.com which was launched with $46 million in venture capital, as well as investments and commitments from wholesalers and their trade association.

22. Such a system could be effectively developed if there were competitive pressure on wholesalers to support it, make the necessary adjustments in their ways of doing business and support changes in state laws so that the products would flow smoothly to the customer. But there is not incentive to make investments and changes because the wholesalers have been able to obtain protective and anti-competitive legislation prohibiting direct shipment and eliminating any opportunity for effective competition through pull marketing.

23. A dramatic example of obstructionism is the passage, in 1997, of Florida HB 725 making it a felony to ship directly to Florida consumers and restricting who might obtain a wholesaler license. This legislation was characterized by Attorney General Robert Butterworth as legislation "[which allows the Florida alcoholic beverage industry] to tighten its vise grip on the distribution of alcoholic beverages. . . . [a bill which] is the perfect tool for the vested interests who

seek additional control over the marketplace, at the expense of competition and consumer choice. The legislation is anti-competitive, it is hostile to Florida consumers, and [it is] self protective." (May 17, 1997 letter from A.G. Bob Butterworth to Florida Governor Lawton Chiles recommending a veto of the legislation). It is almost as if the wholesalers working with friendly state legislatures, well greased with money, developed impediments to make it virtually impossible for wineries in other states to serve their customers without making unrealistic expenditures.

24. AVA worked hard to make a three-tier "pull marketing" scheme work. After formulating the idea of using the three tier system, AVA continued to support the concept to members. The association worked creatively for small quantity exemptions to restrictive state laws requiring wine be delivered and held at wholesaler premises, requirements for supplemental state label approval, long term commitments to particular wholesalers, wholesaler exclusivity laws and the like. Yet the wholesalers, who could easily use their political influence to erase those impediments, continue to choose the monopolistic approach of ignoring the demand and interest in special orders in favor of maintaining their comfortable status quo. Three tier "pull marketing" was a massive bureaucratic failure.

25. At the state level, wine is subject both to an excise tax based on gallonage and to sales/use taxes based on a percentage of the value of the product as would be applicable to any other consumer product. Much has been made about lost tax revenue which might arise from the interstate shipment of wine to New York consumers. Careful analysis suggests that these arguments are grossly overstated.

26. New York State taxes table wine at $0.19 per gallon, so each bottle is subject to an excise tax obligation of just under four cents per bottle. The excise tax on 100 cases of wine is approximately $45. AVA estimates that the maximum potential for out of state direct shipment of wine to be 0.5% of the total wine market, since the cost and trouble of purchasing in that manner makes it a very secondary avenue for selling or purchasing wine. At that level, and assuming the New York table wine market to be 40 million gallons per year (Adams Business Media, Handbook Advance 2001), New York would lose less than $40,000 per year in uncollected wine excise taxes *even if it did not collect a single penny of taxes on direct shipment through a permit system.*

27. Payments of use taxes for sales made outside the State of New York to New York residents are the responsibility of New York citizens. Underreporting of those taxes is rampant but there is no way to differentiate wine from any other products purchased out of state. The Congressional General Accounting Office (Sales Taxes, June 2000, GAO 00-165) has estimated that New York will lose between $0.5 and $2.4 billion per year in uncollected use taxes on remote sales of all types of goods by the year 2003. Nationally the estimate of uncollected use taxes suggests that these could amount to over $20 billion per year by 2003. Wine is a tiny portion of the potential loss. Using the AVA estimate of interstate shipment potential as 0.5% of total wine market, the $20 million represented by those sales generates a possible tax loss of $1.6 million or 0.11% of the average projected loss New York State might suffer due to uncollected use taxes.

28. But New York need not lose any revenue because of interstate direct shipment of wine. Several states including Nevada, New Hampshire, North Dakota,

Louisiana and Wyoming have chosen to establish a system for a direct sales permit where all taxes, including excise and sales taxes, are collected by the shipping winery and are remitted to the states in question. Another way to recapture virtually all of the potential lost revenue would be to solve the global problem of uncollected use taxes by establishment of a federal requirement for businesses to collect and remit those taxes as is currently being negotiated between state Governors and Congress (National Governors Association Policy EC-12).

Age Verification

29. Questions have been raised about the potential for underage persons using direct shipment as a means of obtaining alcoholic beverages. Underage consumption of alcohol does occur in this country but virtually all of the products so consumed originate within the three tier system and are purchased illegally by underage buyers or their surrogates.

30. It is well known that underage drinkers are not seeking out premium table wine, paying extra shipping charges and waiting a week or two for delivery. The likelihood of underage buyers taking the trouble, exposing themselves to discovery, leaving a documentary paper trail and paying the costs of home delivery by common carrier is very minimal, a fact confirmed time and again by regulators in states where direct wine shipment is commonplace, such as California and indeed New York. The Deputy Director of the Alcohol Beverage Control in California – where direct shipping has been legal for decades – provided written testimony to the U.S. Congress stating that direct shipping is not a source of underage access to wine, beer or spirits (March 3, 1999 letter from Manuel R.

Espinoza to Congressmen Thompson and Radanovich).

31. There is no evidence that direct shipment of wine, beer or spirits to underage buyers represents a significant regulatory problem even though 37 states, representing 81% of the country's population, including New York state, allow either interstate or intrastate delivery of either wine, beer or spirits. The Department of Health and Human Services estimates that more than half of 18-21 year olds drank alcohol in the month before their 1999 National Survey on Drug Abuse. Yet, outside of contrived and unrealistic "stings", there is virtually no evidence of underage persons receiving deliveries of wine, beer or spirits by common carrier.

32. It is typical for direct shipments of wine, beer or spirits to be labeled "adult signature required" (UPS). All the reciprocal shipment laws require such labeling. Some common carriers require the person receiving such shipments to present proof of age, which states may, of course, require. Most wineries require an affirmation of age on the part of the buyer before taking an order. In sum, direct shipment provides both opportunities for age verification as well as practical impediments to underage access, making it a highly unlikely means for minors to obtain alcohol.

Risks for Companies Selling Directly to Underage

33. Companies that violate direct shipment laws requiring proper labeling and other such precautions undertake severe risks to the continuation of their business. Violations can be prosecuted by authorities in the receiving states through long arm statutes (such as Utah vs. Beer Across America), through filing for injunctions in Federal Court under the 21st

Amendment Enforcement Act, though complaints lodged with the regulatory authorities in the states in which they are licensed and finally, for wineries, through initiation of regulatory action by the Federal Bureau of Alcohol, Tobacco and Firearms (Industry Circular 96-3, February 11, 1997), which can revoke their authority to produce wine.

Conclusion

34. While opponents argue that state interests such as concerns for lost revenue or underage access to alcohol might be considered in New York's policy towards interstate direct shipment of wine, the facts belie the significance of direct shipment contributing to the alleged regulatory and fiscal problems. Tax losses are de minimus and could easily be remedied through less proscriptive means. Similarly there is no evidence that the underage seek to turn to direct shipment of wine as a mechanism for obtaining alcohol. Adequate protections against that possibility are already in place and violations can be addressed through enforcement actions.

35. Meanwhile, because of the constraints of current statutes, New York citizens are discriminated against by the inability to obtain wines of their choosing, wineries through the country are unfairly excluded from interstate commerce with their customers in New York and, as a result, New York state wineries are excluded from reciprocal access to their consumers in other states.

/s/ Simon Siegl
Simon Siegl

Subscribed and sworn before me this 26th day of September 2001.

/s/ Notary Public,
State of Washington
District of Columbia

Notary Public
My Commission expires Sharon L. Brown

SHARON L. BROWN
Notary Public, District of Columbia
My Commission Expires July 14, 2004

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Exhibit 22 to Declaration of Clint Bolick, executed on October 11, 2001, in support of Plaintiffs' Reply Memorandum in Support of Motion for Summary Judgment, dated October 17, 2001 – Supplemental Affidavit of Juanita Swedenburg, sworn to on September 26, 2001

SUPPLEMENTAL AFFIDAVIT OF JUANITA SWEDENBURG IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' AND INTERVENOR DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

CITY OF MIDDLEBURG)
) SS.
STATE OF VIRGINIA)

Juanita Swedenburg, being first duly sworn, upon oath, states as follows:

1. I am a citizen of the United States, a resident of the State of Virginia, and over 18 years of age. I am a plaintiff in this action. I make this affidavit based on my personal knowledge of the facts set forth and am competent to testify thereto if called as a witness at trial.

2. Swedenburg Winery is a very small producer that sells small amounts of our specialty wine to customers, many of whom like buying our wine as a reminder of

their visit to our winery. We are nowhere near as large as a Gallo or a Kendall-Jackson.

3. I estimate that if we were allowed to direct ship in New York, we would sell approximately ten to fifteen cases a year to New York customers. That may not sound like a lot, but it is a significant part of Swedenburg Winery's sales. On the other hand, I know from experience that, for a wholesaler, ten to fifteen cases is an extremely small volume – not enough to bother with. In any case, as a small producer, we cannot afford the time and money it would take to find a wholesaler in New York. Trying to find a wholesaler in all fifty states would be even more prohibitive.

4. Even if we did find a wholesaler that would actually carry and, more importantly, sell our wine, the mark-up we would have to give to that wholesaler would wipe out our entire profit margin. It costs us more to produce our product as a small winery because we have such a small volume, so we cannot afford to have a wholesaler take its large cut the way a bigger winery can. It is only by selling directly to customers and having our customers cover all shipping costs, which our customers do, that we are able to stay in business. If we had to ship through wholesalers, our business would definitely go under. It's that simple. I don't think that makes us greedy for not using a wholesaler. We just want to stay in business.

5. For us, the wholesaler adds absolutely nothing to the transaction. Our customers contact us directly. There is no role of value a middleman can play, but it would add cost and inconvenience in the detriment of both the winery and the customer.

6. Most of our out-of-state sales are to people who have visited the winery. We don't always know where our visitors are from, so it is difficult to say how many

people visit from New York, but I would estimate that we see at least 50 visitors from New York annually.

7. There is no New York license available for out-of-state wineries. The intervenors have said all we need to do is to become a New York winery or wholesaler. The idea of Swedenburg Winery getting a New York winery or wholesaler's license to ship ten to fifteen cases a year as the intervenors have suggested is ludicrous. It would be a downright stupid business decision to spend $10,000 (I understand that is John Dyson's testimony of approximately how much it cost him to get a New York wholesaler's license) in order to sell such a small volume. It is economically infeasible for a winery of our small size to consider such a thing. That $10,000 alone would put us out of business, and there would be costs above and beyond that.

8. A New York wholesale licensee has to have an office in New York State, but we do not have any land up there. We would have to pay to rent a place and pay the utilities. And the New York law says we would also have to hire an employee to be there during business hours. I don't think we could do that for less than $50,000, even if we just had a little shabby room. And we'd need a temperature-controlled warehouse, which under the New York law would have to have a separate entrance, if not its own building. We simply could not afford the time or money all this would require.

9. Trying to open a licensed winery in New York would be even more expensive and burdensome. Again, we would have to have a New York presence, but we have no land in New York. We could never afford to buy land in New York and build up a new winery there. We have already spent a million dollars on our Virginia winery, and we don't have another million. Besides, we are a Virginia winery and we don't intend

to have satellite wineries everywhere else. We would lose our identity.

10. All we want to do is sell as much of our wine as we are able to our special customers in New York. These are mostly people who come to visit our winery and then call once they get back home, wanting a case or two of our wine. They like the wine and they like the novelty of ordering from a place they have visited. The appeal of Swedenburg Winery for these sorts of customers is that we are small, and we want to stay small.

11. We are very proud of the quality of our wine. We regularly enter international competitions and competitions throughout the United States where we are up against every winery in the country. And we like it that way. We consider the entire country our market, and it is especially rewarding for us when we win a medal after going up against the whole country or even the whole world. In total, our wines have won over two hundred medals. Of course, the most important judges of the quality of our wine are our customers who like our wine enough to buy it for themselves and their friends. We have never had a customer complaint about the quality of our wine and we have many repeat customers.

/s/ Juanita Swedenburg
Juanita Swedenburg

Subscribed and sworn before me this
26 day of Sept. 2001.

Notary Public, City of Middleburg,
State of Virginia.

/s/ _____
Notary Public
My Commission expires 9-30-05

City/County of Loudon
Commonwealth/State of VA
The foregoing instrument was acknowledged
before me this 26 day of Sept., 2001, by
Juanita Swedenburg
(name of person seeking acknowledgement)

/s/ _____
Notary Public
My commission expires: 9-30-05

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

Exhibit 28 to Declaration of Clint Bolick, executed on October 11, 2001, in support of Plaintiffs' Reply Memorandum in Support of Motion for Summary Judgment, dated October 17, 2001 – Supplemental Affidavit of John Dyson, sworn to on September 21, 2001

SUPPLEMENTAL AFFIDAVIT OF JOHN DYSON IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

CITY OF NEW YORK)
) ss.:
STATE OF NEW YORK)

John Dyson, being duly sworn, declares as follows:

1. I am an expert witness in this litigation. I make this affidavit based on my personal knowledge of the fact set forth below.

2. In their opening brief, defendants have mischaracterized my previous testimony and have made factual assertions I know to be untrue. In particular, they have (1) cited Millbrook Winery's relationship with a New York wholesaler to illustrate the purported benefits of the three-tier distribution system for wine; (2) cited the fact that my California winery can ship to New York residents

through my New York winery as evidence that no barriers to entry exist for out-of-state firms; and (3) contended that few New York wineries ship directly to New York residents.

3. In my prior affidavit, I expressed my views on the requirement that out-of-state wineries must use wholesalers to distribute wine in New York. For small wineries, it often makes no sense. In my experience, such relationships are costly, inefficient, and add little or no value to the transaction between winery and consumer. For that reason, we have terminated relationships with wholesalers where possible and prefer to sell or ship directly to consumers.

4. It is true, as I previously attested, that Millbrook Winery recently signed an agreement with a wholesaler to distribute some of our wine in limited parts of New York. The wholesaler made unusual concessions. The reasons it did so were clear: Millbrook is a well-established brand in New York, and we turned over our active accounts to the wholesaler. We are waiting to see whether the wholesaler can increase sales. It is only with those unusual concessions that it made economic sense for us to engage a wholesaler, and it remains to be seen whether it will work.

5. The key point is that it is only because Millbrook has the option of shipping directly to New York consumers that we have been able to establish our brand and negotiate an attractive deal with a wholesaler. We have not been able to do so in other states where Millbrook is less-established; nor would I expect that small out-of-state wineries could reach a similar agreement with a New York wholesaler absent a well-established reputation or customer base.

6. Nearly all New York wineries engage in direct shipping. Most New York wineries are small and each accounts for a tiny percentage of the overall volume of New York wines. Because they are located in prime tourist regions, they have visitors from all over. Orders from visitors account for a significant portion of in-state sales. Before a clamp-down on interstate shipping, many New York wineries shipped to out-of-state customers as well, and business has suffered now that they cannot do so. Direct shipping is a major element in the financial picture for the large percentage of New York wineries that are small.

7. It is good fortune that before purchasing Williams and Selyem Winery in California, I already owned a winery in New York. That is the only way we can ship wines made to Millbrook's specifications at our California winery to New York consumers. Certainly, we could not have opened a New York winery in order to distribute our California wines. Defendants' suggestion that out-of-state wineries can easily make millions of dollars of investments to open a New York winery in order to sell a bottle of wine to a customer is preposterous. Likewise, having to open a New York wholesaling operation makes no economic sense to a small out-of-state winery. It was precisely this sort of economic barrier that the commerce clause was designed to prevent.

8. We remit taxes on wines shipped directly to consumers to all states that require them, including California, New York, New Hampshire, Louisiana, and Nevada.

/s/ John Dyson
John Dyson

Subscribed and sworn before me this
21 day of September 2001.

Notary Public,
State of New York

/s/ Maureen Webb
Notary Public

My commission expires 5/10/03

MAUREEN WEBB
Notary Public, State of New York
No. 01WE6024321
Qualified in Kings County
Commission Expires 5/10/03

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 00 CV 778 (RMB)

[Caption Omitted In Printing]

SUPPLEMENTAL AFFIDAVIT OF HOWARD P. KITT

STATE OF NEW YORK)
) ss.:
COUNTY OF WESTCHESTER)

HOWARD P. KITT, being duly sworn, deposes and says:

I. INTRODUCTION

1. I am an economist and Senior Vice President employed by National Economic Research Associates, Inc. ("NERA"), based in White Plains, New York. On behalf of counsel for Defendants, I filed an affidavit in this case in 2001.[1] My curriculum vitae was previously submitted to the Court.

2. Counsel for Defendants have asked me to quantify for the Court, based on the materials I have already presented with my original affidavit, the amount of wine New York State (NYS) wineries ship directly to NYS consumers. As I explain below, based upon data reported in the *1998 Survey of New York Wineries* ("the survey"), on

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[1] Affidavit of Howard P. Kitt, sworn to on August 16, 2001.

which I relied for my original affidavit,[2] direct shipments to New York State consumers account for a very small percentage of NYS wineries' sales – well under 1% and probably close to 0.5% of total volume – and an even smaller percentage of wine consumption in the state.

II. FINDINGS

3. Various tables in the survey report results for wineries categorized by two alternative geographical classifications: (i) Bureau of Alcohol, Tobacco, and Firearms (BATF) viticulture regions ("BATF regions") or (ii) wine trails. In this affidavit, I focus on two of those tables, "Percent of Total Wine Sales and Dollars by Type of Sale by [BATF] Region, 1997" and "Percent of Wine Sales by Location, Wine Trail, & Year," which also reports data for 1997 (and for 1985 and 1995 as well).

4. As I noted in ¶28 of my original affidavit, the survey questionnaire asked wineries to divide their sales into four types: (i) direct to consumers at the winery; (ii) direct to restaurants and liquor stores; (iii) through a New York distributor; and (iv) Other, which includes both shipments to out-of-state customers and direct shipments to New York consumers.[3]

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[2] *1998 Survey of New York Wineries*, New York Agricultural Statistics Service ("the survey"), originally available at www.nass.usda.gov/ny/bulletin/Winery/winery.htm. See footnote 23 and the discussion of some of the survey results at ¶¶26-28 of my original affidavit.

[3] Survey questionnaire, Section 5, for *1998 Survey of New York Wineries*, New York Agricultural Statistics Service. The table summarizing responses to that question, "Percent of Total Wine Sales and Dollars by Type of Sale by Region, 1997," lists the first type of sale as

(Continued on following page)

5. The first of the two tables mentioned in ¶3, "Percent of Total Wine Sales and Dollars by Type of Sale by Region, 1997," summarizes responses to that question for wineries in five BATF regions (Long Island, Hudson River, Cayuga Lake, Finger Lakes, and Lake Erie) and for "none" (*i.e.*, wineries that aren't located in a BATF region). For wineries located in three of those regions (Hudson River, Cayuga Lake, Lake Erie) and wineries in "None" of them, the last type of sales, "Other," accounted for 1% or less of the volume of wine. That percentage overstates the percentage of those wineries' volume that they shipped directly to NYS consumers, because, as noted in ¶4 above, "Other" includes shipments to out-of-state customers as well (including both wholesalers and out-of-state consumers). For wineries in the Long Island BATF region, the percentage of sales in "Other" is only 4%, which, for the same reason, overstates the percentage of wine shipped directly to NYS consumers.

6. For each of those regions, therefore, sales of the first three types listed in the table (direct to consumer at the winery, direct to restaurants and liquor stores, and through a NY distributor) account for at least 96% of total volume (and an even higher percentage for all but one of those regions). It follows *a fortiori* that those first three types of sales – *i.e.*, in-state sales of all types *except* direct shipments to consumers – account for at least 96% of those wineries' total sales within NYS. Equivalently, direct

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"Direct to Consumer." It is clear from the survey questionnaire itself, however, that that type includes only direct sales to consumers *at the winery*. (See question 4 in Section 5 of the survey questionnaire.) I have verified that fact, as well as the other definitions used in that survey, with State Statistician Stephen Ropel, who I understand oversaw and was responsible for preparation of the survey.

shipments to consumers accounted for less than 4% of their total sales within the state.

7. For the only other BATF region listed, the first table ("Percent of Total Wine Sales and Dollars by Type of Sale by Region, 1997") by itself provides less useful information for placing an upper bound on the percentage of wine shipped directly to NYS consumers: It indicates only that the "Other" category accounted for 87% of volume. Recall, however, that "Other" includes both shipments to out-of-state customers and direct shipments to New York consumers, and that table alone provides no information regarding the breakdown of "Other" between those two types of sales.

8. However, the second table mentioned in ¶3 above, "Percent of Wine Sales by Location, Wine Trail, & Year," does shed light on that question. That table shows the percentage of wine sold in three locations (NYS, Other States, and Other Countries), for each of six wine trails and for "None" (*i.e.*, wineries that are not on any of the six wine trails). As I explained in footnote 29 of my original affidavit, there is considerable overlap between the Finger Lakes BATF region and the wineries that were not located on any of the listed wine trails. For the latter wineries, those grouped as "None" in "Percent of Wine Sales by Location, Wine Trail, & Year," the survey results show that only 11% of their wine was sold in NYS in 1997.

9. That percentage, 11%, includes *all* types of sales within the state, not just direct shipments to consumers. Recall, moreover, that for five of the six regions listed in "Percent of Total Wine Sales and Dollars by Type of Sale by Region, 1997," direct shipments to consumers accounted for less than 4% of total sales within the state. If

that same upper bound percentage, 4%, is applied to wineries that are not listed on any wine trail (which, as noted above, overlap considerably with those located in the Finger Lakes region), direct shipments accounted for less than 0.5% (4% of 11%) of those wineries' sales.[4]

10. Note finally that wineries that are not on any of the wine trails listed in the survey account for the vast majority of wine produced in the state – 96% of production in 1997, according to the survey.[5] Those wineries, therefore, would be weighted most heavily in any weighted average of all wineries in New York State. Accordingly, based upon these survey results, for the state as a whole, well under 1% of the total volume of wine produced by New York State wineries – and probably close to 0.5% – is shipped directly to NYS consumers. Moreover, since NYS consumption of wine in 1997 exceeded NYS production of wine, direct shipments by NYS wineries to NYS consumers accounted for an even smaller percentage of NYS wine consumption. Specifically, in 1997, production of wine in New York State was roughly 77% of consumption of wine in the state.[6] Accordingly, direct shipments by NYS wineries accounted for

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[4] I understand that wineries that are not on the listed wine trails are, by and large, commercial wineries. It is not surprising, therefore, that they ship such a small percentage of their wine directly to consumers.

[5] See the table entitled "Wine Production and Capacity, By Wine Trail," which shows that wineries that are not on any of the wine trails listed in the survey produced 30.426 million gallons of wine in 1997, or nearly 96% of total production by New York wineries of 31.733 million gallons.

[6] See ¶26 of my original affidavit.

well under 0.8% – and probably close to 0.4% – of NYS consumption of wine.

/s/ Howard P. Kitt
Howard P. Kitt

Subscribed and sworn to before
me this 2nd day of December, 2002

/s/ Rita Satenstein
Notary Public

My commission expires 8/15/2006

RITA SATENSTEIN
Notary Public, State of New York
No. 4938855
Qualified in Westchester County
Commission Expires 8/15/06